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Caledonian MacBrayne
Hebridean & Clyde Ferries

ANNUAL REPORT & ACCOUNTS
2004 - 2005

Highlights of the year

- **Passenger carryings up by 2.8% to 5.4 million**
- **Car carryings up by 5.3% to 1.1 million**
- **MV Bute entered service on the Wemyss Bay to Rothesay service**
- **New purpose-built Terminal Building and improved marshalling area at Oban completed**
- **Funding for a second new vessel for the Wemyss Bay to Rothesay service and a new Largs/Cumbrae vessel confirmed**
- **Permission granted for provision of second linkspan at Oban**

Contents

Chairman's Statement

Headline text: 2004/05 has been a successful year financially, commercially and operationally

At the end of my second three-year term as Chairman, I am pleased to report that 2004/05 has been a successful year financially, commercially and operationally, building on the foundations of the Company's performance in previous years .

In financial terms, we recorded a profit of £805,000 before tax and after receipt of deficit grant of £25.9m. This is a satisfactory outcome given our remit to 'break even' before tax. This result was achieved with the same level of deficit grant from the Scottish Executive as last year. Despite indifferent weather during the summer period compared with the previous year, it was a year of further growth in traffic levels, with passenger and car carryings increasing by 2.8% to 5.4 million and 5.3% to 1.1 million respectively; commercial vehicle carryings were broadly similar to those in 2003/04. Overall, fares revenue increased by 6.7% to £49.9m. These increases reflect the success of our various marketing initiatives designed to increase awareness of our services to a wider range of customers.

Our operating expenditure increased by 4.4% to £74.5m, mainly the result of new manning requirements associated with EU Working Hours Directive, increased pension fund costs and general inflation; without the benefit of a fuel hedge, our costs would have been some £2m higher.

The Company met all of the performance targets set by the Scottish Executive. These relate to service reliability and punctuality, fares income and operating costs and are detailed on page 12 of the Report.

We took delivery in June 2005 from the Remontowa yard in Gdansk, Poland, of our new lower Clyde replacement vessel, MV *Bute*. We were delighted that Mrs Marjorie Bulloch, a long-established and well-known resident of the Isle of Bute, agreed to sponsor the new vessel, naming her at a ceremony in Rothesay on 1 July 2005. MV *Bute*, which entered service shortly after her naming on the Company's busiest route, Wemyss Bay to Rothesay, can carry up to 60 cars (almost twice the capacity of the 'Streaker'-class vessel she replaced) and up to 450 passengers.

Another important development over the last year has been the completion of our new purpose-built terminal building at Oban, designed to accommodate direct gangway access to both the existing berth and the proposed second berth. The space made available from the demolition of the old terminal building has been utilised to improve the vehicle marshalling arrangements. Following a public local inquiry, the Minister announced in June 2005 approval of the Company's proposal to build the second linkspan at Oban.

Our commitment to the island and peninsular communities was further evidenced by the completion of the Small Isles terminal facilities, funded jointly by Highland Council and the Scottish Executive, thereby allowing improved access to the service vessel MV *Loch Nevis*.

In December 2004, the then Transport Minister, Nicol Stephen MSP, announced further capital investment for the Company over the next three years. This included funding for a further two new vessels, the first of which is a second new vessel for operation on the Wemyss Bay - Rothesay service, at an estimated cost of £9.5m, . The other new vessel, estimated to cost £5.8m, will replace one of the two existing vessels currently operating on the Largs - Cumbrae service, which will be transferred to the Oban - Lismore service. The Minister also confirmed funding in the period up to March 2008 for shore infrastructure, including a major upgrade of berthing facilities at Kennacraig, as well as works at Largs, Cumbrae, Wemyss Bay and Lismore to accommodate the new or cascaded vessels, and a replacement linkspan at Brodick. The Company warmly welcomes this substantial investment in the Clyde and Hebrides Ferry Services.

The Company's now established tradition of holding a number of our Board Meetings at locations in the network continued. In 2004/05, meetings were held in Largs and Mallaig and provided an opportunity for the Board and management of the Company to meet representatives and members of the local communities in a relaxed and informal environment.

The Company recognises that safety and the security of operation of our ships and shore facilities is of paramount importance. While the safety record of the Company remains excellent, we consider it essential to keep practices impacting on safety under constant review. Information on the Company's safety procedures is given in the Report of the Directors.

We are currently reviewing our environment policy with a view to aligning it with UK and European legislation and we are also taking action where necessary, in discussion with the security authorities, to ensure compliance with the new security legislation. All of this is designed to ensure that our customers and staff experience the highest levels of safety and comfort.

As a result of revised funding arrangements with the Scottish Executive, our 50% joint venture shareholding in NorthLink Orkney and Shetland Ferries is in a healthy state. In July 2005, the Scottish Ministers announced that the Company had been short-listed under the re-tender process for the Northern Isles ferry services.

I reported last year that the Company's Pension Scheme was in deficit. This remains the position, as shown in the FRS 17 transitional disclosure contained in note 16. A full actuarial valuation of the Company's Pension Fund was undertaken as at 6 April 2004. Based on actuarial recommendation, endorsed by the Trustees, the contribution levels of both employer and employee were increased with effect from April 2005. The Company also committed to a further lump-sum payment of £1.7m into the Fund during the financial year 2004/05.

In relation to activities outwith the Undertaking, we are currently in discussion with the Northern Ireland Department for Regional Development about a further one-year extension to the contract for operation of the Ballycastle - Rathlin service to March 2007. Our operation there has also been enhanced by our recent move into Moyle District Council's spacious ferry terminal building at Ballycastle, underlining the continuing success of this activity.

I am pleased to report that Alex Lynch was re-appointed as Finance Director for a further three-year period and that Jan Nicolson's appointment as Non-Executive Director was extended for a further six-month period to the end of September 2005. I am also pleased that the Scottish Ministers have extended my own appointment as Chairman for a further period.

The issue of tendering the Clyde and Hebrides ferry services remains uppermost in our minds. In the absence of a firm decision that tendering will go ahead, the Company continues its efforts to be in a position to submit a winning bid if and when invited to do so. The new vessels and pier infrastructure, the commitment to safety and security, and our ongoing dialogue with and within the communities we serve, which have resulted in substantial enhancements to service provision, will all play their part. The Company will also continue to focus on increasing traffic carryings and controlling costs, with the objective of providing an improved "value-for-money" service. As part of its ongoing strategy, the Company is considering a move to offshore crewing

The Company's most important asset is its workforce. I wish to thank all the Company's staff, management and Board Members for their continued enthusiasm, commitment and hard work. I also wish to thank the Scottish Executive for its continued support.

Dr Harold Mills
Chairman

Managing Director's Review

Headline text: The level of fares and standard of service we provide for our customers represents value for money

This has been a year of great achievement for the Company in meeting its responsibilities to the island communities and visitors alike.

We carried more than five million passengers and one million cars and I acknowledge the efforts of our staff in meeting customer demands and expectations in one of our busiest years on record.

We introduced several enhancements to our services during the year which have impacted positively on our performance. The Winter service to Arran was extended with additional return sailings. Additional sailings were introduced on the Sconser - Raasay service and early morning sailings on the Tayinloan - Gigha service were introduced on an all-year round basis. Additional sailings were introduced on the Ullapool - Stornoway service and we repeated our provision of a two-vessel service to Islay during the major part of the Summer season.

Although commercial vehicle activity was largely similar to the previous year, I feel that this was indicative of the level of economic activity on the islands generally, rather than any reflection on our service. For a second year, we did not apply any increase on the fares for commercial vehicles on services within the Undertaking, while fares for passengers, cars and coaches were increased by 2.5% in line with the general level of inflation.

We are confident that the level of our fares and the standard of service we provide for our customers represent value for money.

Our new lower Clyde replacement vessel was launched at the Remontowa yard at Gdansk in Poland in February 2005 and took up service on the Wemyss Bay - Rothesay service in July 2005. In addition, the then Transport Minister, Nicol Stephen MSP, announced funding for the provision of a second new vessel for the Wemyss Bay - Rothesay service and a new vessel to operate on the Largs/Cumbrae service. This will allow the Company to transfer one of the present vessels operating on the latter service to provide much needed additional capacity on the Oban - Lismore service.

In the latter part of 2004, we disposed of MV Pioneer, which had served in the Company's fleet since 1974.

Along with the provision of new vessels, we have continued our programme of upgrading existing vessels with the refurbishment of the children's play area, snack bar and main foyer on MV Isle of Lewis, the cafeteria areas and games room on MV Isle of Mull, the main foyer on MV Lord of the Isles and the observation lounge on MV Clansman. In addition, the programme of installing Hi Fog fixed fire-fighting systems and modifying the fast rescue facilities on major vessels was completed.

Our new terminal building in Oban became operational in April 2005 and reflects the high standards of passenger comfort and experience to which we aspire across the network. The space made available by the demolition of the old terminal building will allow us to improve the vehicle marshalling arrangements.

We introduced shore ticketing during the year on all major Clyde services; this included automated ticketing and photo-season tickets at certain locations, which provide customers with a new dimension in travel convenience. Initial teething problems with the new procedures have now been resolved.

Our Disability Steering Group assesses, on a regular basis, the needs of those passengers with impaired mobility and brings forward recommendations. Acting on these recommendations, the Company has identified several areas for improvement and has set in place a number of new initiatives. Most notable are the introduction of braille signage at our new Oban terminal building and our policy of ensuring that all new vessels are constructed to meet standards current at the time.

The Company's restructured website design is an important factor in raising awareness of the services we provide and has contributed to our improved performance in meeting the continuing increased customer preference for on-line booking. Our reservations system is now able to take bookings in November for the following Summer and Winter periods, thereby providing customers with improved flexibility and choice. We are also starting to see the benefits of our first-ever television advertising campaign which was supported by targeted direct mail.

We have upgraded our telephone system to allow the deployment of staff at various locations in the network to be involved in the reservations process, thereby improving efficiency and extended availability to customers.

The Safety Committee meets regularly and the Company works closely with the relevant authorities to ensure that our customers and staff experience a safe, secure and comfortable environment.

The Company has received a regular flow of requests under the Freedom of Information (Scotland) Act 2002 since it became fully effective in January 2005. It is our policy to ensure that all requests receive a response within the timescale set out in the legislation.

Business risk assessment is an ongoing process by which the Board seeks assurance as to the quality of controls in place in relation to areas of key risk across the Company's operations. The Business Risk Assessment Schedule is reviewed annually to ensure that the documented risks are still relevant and that any new risks that have arisen are also assessed. This review is facilitated by the Internal Audit department. An initial review of the Business Risk Assessment Schedule is made and approved by the Executive Directors before being presented to the Audit Committee for consideration. Once approved by the Audit Committee it is presented to the Board for formal approval.

The Information and Consultation Regulations came into effect on 6 April 2005. *The Company has taken this as an opportunity to establish a consultation forum which consists of representatives from all grades and departments within the Company. The forum will meet twice yearly and the first meeting was held in May 2005; topics for discussion include Company performance, strategy and finance.* Quarterly *meetings take place with Trade Union representatives to discuss and resolve local issues. This process is well received and, as a result of this regular dialogue and interaction, the present climate of industrial relations is very positive.*

I am pleased to report that the Company has negotiated a satisfactory long-term pay deal with all the main Trade Unions which should bring stability in industrial relations through to October 2008.

During the year, it was decided that the Company should confirm its commitment to the environment by obtaining accreditation to the environmental management standard ISO 14001. We plan to obtain accreditation by the end of September 2005 and the work towards achieving this is well under way. Care of the environment features high on our management agenda and we have produced a new environmental policy which is available on our web site as well as being placed on port and vessel notice boards.

The Company's commitment to regional management and the support given to regional management teams from within the Company continues to improve efficiency across the network. Focus at local level ensures that emerging issues are identified at an early stage and appropriate action taken. This leads to improved relations with the communities we serve and provides a forum for identifying areas where change or improvement is needed.

Despite the continuing uncertainties associated with the proposed tendering of the Clyde and Hebrides ferry services, the Company continues to build on its strengths and to focus on maintaining and improving the safety, comfort and quality of service with which we provide our customers.

Lawrie Sinclair
Managing Director

Communication and Marketing

Headline text: The Company is continuing its development of a cohesive marketing strategy

The Company is continuing its development of a cohesive marketing strategy and an important element of this is the Caledonian MacBrayne website which offers the facility of on-line reservations, information on island destinations and allows visitors to request the Company's main brochure "Explore". Visitors to the website can also access timetable information, details of special offers and value fares as well as keeping up-to-date with Company information. The increased number of visits to the website is also contributing to the building of a valuable customer database which can be used in future marketing and communication activities.

The success of the redesigned website was further underlined in May 2005 when the Company was named as the winning Cruise/Ferry Operator in the travelmole.com website awards. With over 300 nominations across the award categories, it was a notable achievement for the Company to win this prestigious award. Travelmole.com is one of the key on-line resources for the travel industry and provides a broad range of information, news and discussion, in addition to reviews and links to other relevant websites.

The Company's second television commercial, launched in April 2005, heralded another year of exciting and fresh marketing and communication activity. The advertisement was again aimed at the 25 to 45-year old market and used the landscape of the Outer Hebrides to introduce the sense of escape and freedom associated with the islands of Scotland to a new and younger audience. The advertisement focused on the premise that Scottish Islands provide the environment for a perfect short break destination for travellers. As research has shown that one of the main barriers to travel is lack of knowledge, the principal aim of the television advertising campaign was again to put the Caledonian MacBrayne brand to the forefront of people's minds and encourage them to consider Scottish islands as an alternative and attractive short break destination.

As with the previous year's television advertisement, viewers were directed to the company's website, **www.calmac.co.uk**, for more information and the facility of on-line booking. The website was refreshed in December 2004 and, in March 2005 alone, received over 600,000 page visits, a significant increase over the previous year.

The Company's Summer cruising season starts with an invitation-only 'Ancient Castles' cruise. Local accommodation providers and media representatives are invited to join Company officials for a buffet lunch on the cruise, which sails from Oban. The cruise is extremely successful in providing an opportunity to thank local accommodation providers for their efforts in promoting the Company's services by stocking our brochures and leaflets, and recommending our tours and cruises. This is an important initiative as accommodation providers are central to our local marketing efforts across the network, particularly during the Summer months.

The Company's marketing activities over the past year have been aimed at enabling the Company to maximise commercial opportunities. A five-year marketing strategy is being developed to allow us to plan for the long-term in identifying opportunities and meeting the challenges we face.

One of the key activities to be developed is the introduction of brand and corporate standards and guidelines across the Company to ensure a consistent and professional image is projected to our customers; another is the promotion of the Company's Mallaig to Armadale service to combat any adverse impact from the withdrawal of tolls on the Skye bridge.

The Company again used the Royal National Mod as a marketing and advertising opportunity to promote the Company's services and destinations. It was appropriate that we used the 2004 event, held in Perth, to launch our new pocket timetables for Winter 2004/05. The mod also provided the Company with an opportunity to introduce, on a trial basis, our timetables in electronic disc format. A convenient and easy means of accessing timetable information for all our services, this represents another innovation in our continued efforts to improve customer communication, and their ongoing production will depend upon customer feedback.

The Company has taken the introduction of the Information and Consultation Regulations as an opportunity to establish a Consultation Forum consisting of representatives from all grades and departments within the Company, which has replaced the Communication Forum. Under the new regulations, the Company has obligations in terms of provision of information to, and consultation with, employees.

Regular meetings are held to ensure that employee representatives are kept up to date with developments and key issues affecting the Company.

The forum also has an input into the planning and operation of other key mechanisms for the dissemination of information including the newly established and developed intranet system, the Company's in-house magazine and direct mailshots to employees' home addresses when issues of importance need to be highlighted.

A whole new range of updated policy and procedure documents have also been prepared to keep employees better informed of their rights and responsibilities.

Customer Care

Headline text: Customer care will always be an important aspect of the Company's operation

Customer care will always be an important aspect of the Company's operation.

During the latter part of 2004, a new unit was set up to deal specifically with customer care issues throughout the Company.

The new unit deals with all customer care issues including feedback from customers, the identification of training needs and performance reporting. Staff within the unit report directly to the Head of Communication and Customer Care, who in turn reports directly to the Managing Director.

The key areas on which the new unit focuses are:

- the establishment and development of a system to administer customer care activities throughout the Company's operation;
- contribution to the production of an effective customer care related strategy and to the development of the Company's overall communications and customer care policies and procedures;
- the development and integration of a coordinated and comprehensive approach to customer care across the company's activities and operation;
- the management of activities including customer feedback;
- ensuring that complaints are dealt with fairly, consistently and resolved within the agreed timescales;
- liaison with and support for Regional Managers in dealing with customer-related issues;
- assistance with the co-ordination of all customer-related activities internally and, in particular, marketing;
- developing communication with appropriate external agencies and customer-based organisations.

The unit has dealt with a number of specific issues which arose during its first six months including the introduction of shore ticketing on Clyde services, the introduction of the new telephone system and the introduction of a training and development plan for the Company's customer feedback recording system. The unit also provides Directors with a regular update of progress in dealing with customers' correspondence and identifies key areas of concern and possible improvement.

The unit has been responsible for developing brand and identity guidelines, as well as Corporate Standards, and provides employees at all levels with clear guidance and advice which should assist in further raising standards throughout the Company. The Corporate Standards document deals with key performance issues such as professional competence, ticket issue and the behavioural and dress code to which employees should aspire.

A recognition scheme which offers employees the opportunity of suggesting cost-effective ways of dealing with areas of concern to customers has also been developed.

Staff Training

A series of customer care training workshops entitled "CalMac Cares" have been held using external consultants and staff at all levels were included. The training took place at various locations throughout the network including on-board a number of the Company's vessels. The evaluation and analysis of the outcome of the training workshops has been used to enable the planning of further training proposals to ensure that the highest standards of customer care are maintained to a set of industry standard benchmarks.

Call-handling training for more than 100 front-line staff coinciding with the introduction of the Company's new telephone system was a key element of the wider training programme.

The Company has produced information, safety and security videos to welcome passengers and familiarise them with the company's services and facilities.

The videos are an excellent means of conveying information to a diverse customer base in a user-friendly format and cover all aspects of customer experience, including pre-arrival advice, ticketing procedures, safety in the port environment and advice to ensure customer safety and comfort whilst on passage. The videos also provide information regarding on-board facilities, the supervision of children, emergency procedures, assistance for customers with impaired mobility and the Company's customer feedback policy.

We have also produced a staff induction video which, coupled with the customer information videos, demonstrates the Company's commitment to the health, safety and satisfaction of customers.

The Fleet

Summer 2005 brochure insert **(excluding 'header')**.

Under Charter - MV Muirneag, MV Ali Cat

Passenger capacities shown are as per Passenger Certificate; car capacities shown are based on an annual analysis of typical vehicle deck utilisation.

Results Analysed by Area of Operation

	2005		2004	
	£000	£000	£000	£000
Operating Loss on Approved Services				
Upper Clyde		**5,871**		5,307
Outer Isles		**11,590**		11,225
Islay/Gigha		**2,299**		3,596
Mull/Colonsay		**2,453**		2,547
Skye and Small Isles		**3,083**		2,198
Arran/Kintyre		**563**		838
		25,859		25,711
Operating profit on other activities	**(334)**		(369)	
Gain on sale of fixed assets	**(100)**		(1)	
Interest receivable	**(330)**		(199)	
		(764)		(569)
Operating Loss before Deficit Grant		**25,095**		25,142
Deficit grant from the Scottish Executive		**25,900**		25,919
Profit before Taxation		**805**		777

The information shown above was prepared on a historical cost basis. Ship costs, including annual overhaul and attributable vessel financing costs, have been allocated on the basis of actual deployment, shore terminal costs on the basis of the routes served by each terminal and overhead costs on a route activity basis.

Five Year Summary of Statistics

	2000/01	2001/02	2002/03	2003/04	**2004/05**
Traffic Carryings (000s)					
Passengers	4,790	4850	4,884	5,214	**5,358**
Cars	920	979	996	1,045	**1,100**
Commercial Vehicles	87	86	86	86	**86**
Buses and Coaches	13	13	13	13	**13**
Deficit Grant per passenger (£)					
Actual	3.97	4.21	3.87	4.97	**4.83**
Real terms (Base: 2004/05)	4.35	4.53	4.10	5.12	**4.83**
Operating Costs per passenger (£)					
Actual (restated for 2000/01)	11.36	12.13	12.68	13.68	**13.91**
Real terms (Base: 2004/05)	12.44	13.07	13.43	14.10	**13.91**
Deficit Grant as percentage of Turnover	32.9%	33.4%	30.0%	35.5%	**34.0%**

Traffic Carryings (000s)

4 graphs

Passengers **Cars** **Commercial Vehicles** **Buses and Coaches**

2004/2005 Performance Targets

	Target	**Outcome**
Financial – Fares income as % of operating costs	65.7%	**67.7%**
Staff Costs - as % of fares income	83.3%	**80.4%**
Reliability - scheduled sailings fulfilled	99.0%	**99.7%**
Punctuality - scheduled sailings on time	98.5%	**98.8%**

Turnover and Expenditure Analysis

Analysis of Turnover

	2005	2004
	£m	£m
Passengers	**15.4**	14.4
Cars	**19.4**	17.7
Commercials/Coaches	**9.0**	8.9
Catering	**4.5**	4.1
Other	**1.6**	1.6
Grants/Subsidies	**26.3**	26.3
Total	**76.2**	73.0

Mixed colour pie chart of 2005 figures

Analysis of Operating Expenditure

	2005	2004
	£m	£m
Fuel	**5.8**	5.1
Maintenance	**9.1**	9.8
Staff and Staff-related Costs	**40.1**	37.6
Depreciation		
(net of capital grants credit)	**2.0**	1.8
Pier dues	**4.9**	4.5
Information Technology and Systems	**2.1**	2.4
Vessel Charters	**1.9**	1.8
Insurance	**1.6**	1.5
Other	**7.0**	6.9
Total	74.5	71.4

Mixed colour pie chart of 2005 figures

Board of Directors and Secretary

Photo caption

Left to right **(seated)** Scott Grier, Dr Harold H Mills, Lawrie Sinclair, Professor Peter K Timms
(standing) Gordon W McKenzie, John A Nicolson, Philip G Preston, Alexander A MacDonald, John Kerr, Alexander M Lynch, John A Macpherson

Dr Harold H Mills CB

Chairman

Harold Mills is a retired Secretary and Head of the then Scottish Office Development Department. Prior to joining the Civil Service in 1970, he was a Research Scientist and Lecturer at Glasgow University. He was elected to Greenock Town Council in 1965, latterly serving as Honorary Treasurer. He has held a wide range of civil service posts in the Scottish Office including Head of Devolution Division and Principal Finance Officer. He is currently Non-Executive Chairman of the Edinburgh World Heritage Trust and Landtrust and a Trustee the Scottish Maritime Museum. He is also a Non-Executive Director of NorthLink Orkney & Shetland Ferries Ltd. in which the Company has a 50% shareholding. He was appointed Chairman of Caledonian MacBrayne in August 1999.

Lawrie Sinclair

Managing Director

Lawrie Sinclair was appointed Managing Director in May 2001. He is a Chartered Engineer with extensive experience in management within the marine industry. Before joining the Company, he was Managing Director of James Lamont Co. Ltd. and Garvel Clyde Ltd., both marine engineers and ship repairers, and most recently Managing Director of Ailsa Troon Ltd., ship builders and marine engineers. He was also Chairman of the Dry Dock Owners Insurance Association and a member of The Management Council of the Ship Builders and Ship Repairers Association. He is a member of the Royal Institution of Naval Architects and a member of the Society of Marine Engineers and Ship Surveyors.

Scott Grier OBE

Senior Non-Executive Director

Scott Grier is Chairman of Loganair and has been involved with that company in other capacities since 1976. He was Chairman of Scottish Tanning Industries between 1997 and 2003. He was a Director of Glasgow Chamber of Commerce between 1989 and 1998 and is a former Chairman of the Chamber's Transportation Committee. He has first hand knowledge of the Highlands and Islands area through his Loganair connection and also in his capacity as a board member of the Scottish Tourist Board, on which he served between 1992 and 1998. He has been a Non-Executive Director of the Company since September 1996.

John Kerr

Technical Director

John Kerr was appointed Technical Director in August 2004. He is responsible for ship, port and terminal infrastructure design, build and maintenance, ship management and passenger and crew safety. He is a Chartered Engineer and a Member of the Institute of Marine Engineering Science and Technology and has extensive experience in fleet management. He previously held senior positions in Acomarit Ltd and most recently was Fleet Technical Director with V Ships UK Ltd.

Alexander M Lynch

Finance Director

Alex Lynch was appointed Finance Director in July 2002. Formerly Finance Director and Deputy Managing Director of ScotRail, he has extensive board and business management skills gained within the public and private rail industry. As Franchise Development Director of ScotRail, he played a significant role in the creation, vesting and eventual franchising of ScotRail in the rail industry privatisation process. An associate member of the Chartered Institute of Management Accountants and a member of the Institute of Logistics and Transport, he is responsible for financial strategy and planning, information technology, accounting and budgetary controls, statutory compliance and purchasing.

Alexander A MacDonald

Non-Executive Director

Alex MacDonald was a Meteorologist in the Ministry of Defence for 34 years and served at many locations in the UK, as well as overseas tours of duty in Bahrain, Oman and Cyprus. He has been a Councillor in the Western Isles for 19 years, serving as Chairman of Transport for 13 years, and is currently serving a second four-year term as Convener of the Council. He is also Vice-President of the Island Commission of Peripheral Regions of Europe. A native of Lewis, he is a fluent Gaelic speaker. He was appointed as a Non-Executive Director of the Company in April 2003.

John A Macpherson

Non-Executive Director

John Macpherson was a senior communications consultant with Ottawa Civic Hospital in Canada and Director of Public and Government Affairs with Atomic Energy of Canada Ltd., prior to returning to Scotland in 1996 to take up the post of Depute Director of the Gaelic Broadcasting Committee. He is also a Non-Executive Director of the UK Atomic Energy Authority. He lives in Harris and is a fluent Gaelic speaker. He was appointed as a Non-Executive Director of the Company in July 2000.

John A Nicolson

Non-Executive Director

Jan Nicolson is a resident of Skye where he has business interests in several retail companies. He is a Trustee of Scorrybreac Land Trust. He is a former Chairman of Skye and Lochalsh Enterprise and a former Board Member of Highlands and Islands Enterprise. He was appointed as a Non-Executive Director of the Company in April 1999.

Philip G Preston

Operations Director

Philip Preston was appointed to the new post of Operations Director in August 2004. He is responsible for retail operations, ticketing, reservations and ship manning and has line management responsibility for Regional Managers. He is a Chartered Engineer, a Member of the Institution of Civil Engineers and a fellow of the Institution of Engineers and Shipbuilders in Scotland. He joined the Company in 1993 and latterly held the post of Deputy Technical Director.

Professor Peter K Timms CBE

Non-Executive Director

Peter Timms lives on the island of Bute and has been Chairman and Managing Director of Flexible Technology Ltd., a company based in Rothesay, since 1981. He previously worked at senior management level in AFA-Minerva (Thorn-EMI) Ltd. in London and in IBM (UK) Ltd. in Greenock. He is a Non-Executive Director and Chairman of the Argyll & the Islands Enterprise Company Ltd., a Non-Executive Director and Chairman of Murray VCT3 plc and a Non-Executive Director and Chairman of Schroder UK Mid & Small Cap plc. He has served as a Member of the Highlands and Islands Enterprise Board, retiring from that post in 1998. He is also a Non-Executive Director of NorthLink Orkney & Shetland Ferries Ltd. in which the Company has a 50% shareholding. He was appointed as a Non-Executive Director of Caledonian MacBrayne in July 2000.

Gordon W McKenzie

Company Secretary

Gordon McKenzie has held the post of Company Secretary since January 1993. He is a Member of the Institute of Chartered Accountants of Scotland. His responsibilities include corporate and legal issues, freedom of information compliance, property ownership and leasing arrangements.

Report of the Directors

The Directors have pleasure in submitting their Report and Accounts for the year ended 31 March 2005.

Results

The Company made a profit of £544,000 after tax. No dividends have been paid or are proposed, which leaves a profit of £544,000 to be transferred to reserves.

Review of the Business and Future Developments

During the year the Company, within the Undertaking, maintained approved services by sea in both the Clyde and Western Isles areas and, in addition, operated services outside the Undertaking in accordance with Government guidelines. Turnover for the year from fares and charges compared with the previous year increased by 6.7% to £49.9m whilst operating expenditure increased by 4.4% to £74.5m.

The Board continues to examine carefully existing practices in order to find more efficient and cost effective ways of delivering and improving standards of service. In the opinion of the Directors, the state of affairs of the Company is satisfactory.

Information relating to investment in ship and shore infrastructure investment is given in the Chairman's Statement.

State Aid

In order to comply with the European Directive on maritime cabotage, which provides that State Aid may be paid only to fulfil a Public Service Obligation, the services so covered must be open to competition. The Scottish Ministers have announced that, in due course, they will invite tenders for the provision of the Clyde and Hebrides ferry services, with the contract being awarded to the tenderer who submits a compliant bid requiring the lowest financial compensation in meeting the defined service requirements and outputs. The Scottish Executive have also invited expressions of interest for the operation of a ferry service between Gourock and Dunoon without subsidy. The implications for the Company of the changes associated with these processes are unclear at this stage.

Political and Charitable Donations

The Company made no political or charitable donations during the year.

Directors and their Interests

The Directors who served during the year and their respective terms of office are as follows:

J A Nicolson	-	30 September 2005	(Chairman of Safety Committee and Member of Communications Committee)
Dr H H Mills	-	31 January 2006	(Chairman of Remuneration Committee)
S Grier	-	31 March 2006	(Chairman of Audit Committee)
A A MacDonald	-	31 March 2006	(Member of Audit Committee and Communications Committee)
J A Macpherson	-	30 June 2006	(Chairman of Communications Committee and Member of Remuneration Committee)
Professor P K Timms	-	30 June 2006	(Member of Remuneration Committee, Audit Committee and Safety Committee)
L Sinclair	-	30 April 2007	
J Kerr	-	30 June 2007	
P G Preston	-	31 July 2007	
A M Lynch	-	24 June 2008	

None of the Directors had any beneficial interest in the share capital of the Company at any time during the year.

The Company is wholly owned by the Scottish Ministers. Under section 741 of the Companies Act 1985, the Scottish Ministers are considered to be a Shadow Director of the Company.

Safety

The Company recognises that safety of operation of the ships and ports is of paramount concern. While the safety record of the Company remains excellent, the Company considers it essential that there is constant review of all practices impacting on safety and that there is a continued vigilance over all aspects of the safety function.

Action has been taken to ensure clear separation of the ongoing safety work from the audit function. Work carried out by the Fleet Operations Department such as maintaining safety certification, compliance with SOLAS (Safety of life at sea) and MARPOL (Marine pollution prevention) rules and compliance in respect of officer and crew certification and qualifications has been made distinct from the audit function required to ensure that all aspects of safety are properly dealt with.

The separation has been accomplished by the appointment of a Shore Safety Manager, to deal with port matters and a Fleet Safety Manager to deal with the ships, each reporting to the Company Safety Manager who in turn reports to the Technical Director on safety matters. These officers monitor the actions and audit the output of the various safety committees ashore and afloat and report regularly to the Executive Directors.

Overseeing these arrangements is the Board Safety Committee which must be satisfied that the necessary care is taken and which reports to the Board on a regular basis.

Employees

The Company has a policy of equal opportunities and non-discrimination in all aspects of employment.

For some years, the vast majority of employees have been formally represented by Trade Unions recognised for collective bargaining purposes; in addition a system of Employee Participation and Consultative Committees has been well established.

Through either the formal negotiating or consultative process, or a mixture of both, employees at all levels, through their representatives, have been provided with information on matters concerning them and are encouraged to be involved in the activities of the Company.

All of these measures are constantly under review to ascertain whether or not improvements can be made.

Policy of Employment of People with Disabilities

It is the Company's policy to consider applications for employment from people with disabilities on the same basis as other potential employees subject to the nature and extent of disability and the degree of physical fitness demanded of the position. Ability and aptitude are the determining factors in the selection, training, career development and promotion of all employees with disabilities. If any employee becomes disabled during the period of employment, the Company will, if possible, retain the employee for duties commensurate with the employee's abilities following the disablement.

Auditors

A resolution to re-appoint KPMG LLP as auditors will be put to the members at the Annual General Meeting.

On behalf of the Board

G W McKenzie, C.A.
Secretary
20 July 2005

Report on Corporate Governance

The Company is committed to high standards of corporate governance, business integrity and professionalism in all its activities.

Throughout the year ended 31 March 2005, the Company has complied with all the relevant provisions of the Combined Code issued by the Committee on Corporate Governance in June 1998 (notwithstanding that the Company is not a listed company to which the provisions are directed) insofar as these have not been superseded by the provisions of the revised Combined Code.

In addition, the Company has complied with the provisions set out in the revised Combined Code issued by the Financial Reporting Council in July 2003 ("the revised code") with the following exceptions:

- there is no Board Nominations Committee as all Board appointments, including their roles and terms and conditions of employment, are determined by the Company's sole shareholder, the Scottish Ministers
- in view of the Company's responsibilities to take account of public sector guidelines, compliance with the provision that performance-related elements of remuneration should form a significant proportion of Executive Directors' total pay package is not appropriate
- the Remuneration Committee does not have delegated responsibility for setting remuneration levels as its recommendations require the approval of Scottish Ministers
- the Remuneration Committee does not become involved in recommending and monitoring remuneration for senior management below Board level except in the cases of the Human Resources Director and the Director of Strategic Development, both of which are non-Board appointments; the overall parameters for pay awards are approved by both the Board and the Scottish Ministers and detailed implementation is the responsibility of the Executive Directors
- in view of the nature of the Company's status, compliance with those provisions that relate to share options, long-term incentive schemes, dialogue with institutional investors and the conduct of the Annual General Meeting is not appropriate

Board of Directors

The Board is the principal decision-making forum for the Company. It has overall responsibility for leading and controlling the Company and is accountable to the Company's sole shareholder, the Scottish Ministers, for financial and operational performance. The Board approves Company Strategy and monitors performance. The Board has adopted a formal schedule of matters specifically reserved for its decision, which is reviewed on an annual basis.

The roles of the Chairman and the Managing Director are distinct and separate, with a clear division of responsibilities.

The Chairman leads the Board and ensures the effective engagement and contribution of all Non-Executive and Executive Directors. The Managing Director has responsibility for all Company business and acts in accordance with the authority delegated from the Board. Responsibility for the development of policy and strategy and operational management is delegated to the Managing Director and other Executive Directors.

There are six scheduled Board Meetings each year. Board Meetings are structured to allow open discussion and all Directors participate in discussing the Company's strategic aims and performance and financial and risk management. The Board is supplied with comprehensive information in advance of each Board Meeting, including financial and operational reports covering the Company's business activities. Members of the senior management of the Company regularly attend and make presentations at Board Meetings. A representative of the Company's sole shareholder attends each Board Meeting.

Board Balance and Independence

The Board currently comprises seven Non-Executive Directors (including the Chairman) and four Executive Directors; one Non-Executive post is currently vacant. The Board considers that, based on the criteria set out in the provisions of the revised Code, all Non-Executive Directors are independent.

The Board functions effectively and efficiently and is considered to be of an appropriate size in relation to the Company's level of business and associated responsibilities.

The Directors provide an appropriate mix of skills, experience and expertise. The Board Committees comprise Directors with a mix of relevant skills and experience such that no undue reliance is placed on any one individual.

The Non-Executive Directors combine broad business and commercial experience with independent and objective judgement and constructively challenge and assist development of strategic matters.

The balance between Non-Executive and Executive Directors enables the Board to provide clear and effective leadership and maintain the highest standards of integrity and professionalism across the Company's business activities. The names and biographies of all Directors are set out on pages 14 and 15.

The Board appoints a Senior Non-Executive Director.

Re-election of Directors

At each Annual General Meeting, one third of the Directors retire and can offer themselves for re-election. Each Director must stand for re-election at least once every three years. Non-Executive Directors may serve on the Board for more than nine years, subject to annual re-election.

Information, Induction and Professional Development

The Chairman ensures that all Directors receive clear, accurate and timely information on all relevant matters. Any requests for further information or clarification are dealt with or co-ordinated by the Company Secretary.

The Company Secretary is responsible for advising the Board, through the Chairman, on all governance matters. All Directors have access to the advice and services of the Company Secretary who is responsible to the Board for ensuring that Board procedures are followed. All Directors are entitled to obtain independent professional advice at the Company's expense.

On appointment, a Director receives a formal induction, including an introductory meeting with the Chairman and Executive Directors. Board Meetings are regularly held at locations across the Company's area of operation which allows Directors to familiarise themselves with and understand local issues. During their term of office, Directors undertake such professional development as is considered necessary in assisting them to carry out their duties as Directors.

Performance Evaluation

The performance of Non-Executive Directors is assessed by the Chairman and the performance of Executive Directors is assessed by the Remuneration Committee. The Chairman's performance is assessed by the Scottish Executive.

Board Committees

To provide effective overview and leadership, the Board has established a number of Committees with particular responsibilities. The Committee Chairmanship and membership is refreshed on a regular basis.

Audit Committee

The Audit Committee is responsible for assisting the Board in discharging its responsibilities in relation to the financial affairs of the Company, the arrangements for accounting, financial reporting and regulatory compliance, the standards and effectiveness of internal control, the arrangements for identifying, evaluating and managing the significant risks faced by the Company and the arrangements for internal and external audit. The Audit Committee meets both the internal and external auditors privately.

The Audit Committee reviews and monitors the independence of the external auditors in relation to non-audit assignments, taking into account relevant ethical guidance.

The Audit Committee undertakes an annual evaluation to assess the independence and objectives of the external auditors and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements.

The present members of the Audit Committee, all of whom are Non-Executive Directors, are:

S Grier (Chair)
A A MacDonald
Professor P K Timms (appointed 27 October 2004)

The Board is satisfied that the Committee Members have recent and relevant financial experience.

Remuneration Committee

The primary function of the Committee is to make recommendations to the Board and the Scottish Ministers on Board Members' pay and conditions, taking due account of the guidelines issued from time to time by the Scottish Ministers in respect of bodies in the public sector. In particular the main items in respect of which the Committee makes its recommendations are as follows:

- basic remuneration levels for Executive and Non-Executive Directors
- targets to be set for the purpose of the Executive Directors' performance scheme
- performance payment awards for Executive Directors under the Executive Directors' performance scheme
- any matter concerning terms and conditions of service of Executive and Non-Executive Directors
- any policy matters concerning benefits for Executive Directors.

The basic remuneration levels of both Executive and Non-Executive Board Members, and any compensation payments relating to loss of office, are set by the Scottish Ministers each year. Under the performance scheme for Executive Directors, it is policy to agree in advance with the Scottish Ministers each year the following:

- financial and quality targets
- personal targets for individual Directors
- related performance scheme awards for various levels of achievement

The members of the Remuneration Committee (all of whom are Non-Executive Directors) are as follows:

Dr H H Mills (Chair)
J A Macpherson
Professor P K Timms

Report on Corporate Governance (Continued)

Board and Board Committee Meetings

The number of Board and Board Committee Meetings held during the year ended 31 March 2005, and the individual attendance by present members, was as follows:

	Board	Audit	Remuneration	Safety	Communications
No. of Meetings held	**7**	**5**	**5**	**4**	**5**
Dr H H Mills	7		5		
L Sinclair	7				
S Grier	7	5			
J A Macpherson	7		5		4
A A MacDonald	5	5			3
J A Nicolson	7			4	5
Professor P K Timms	6	0 *	5	3	
J Kerr (appointed 17 August 2004)	3				
A M Lynch	7				
P G Preston (appointed 25 August 2004)	3				

* Professor Timms was appointed a member of the Audit Committee on 27 October 2004

In addition to these formal meetings, Board Members regularly attend other informal business meetings. Dr Mills and Professor Timms are the Company's representatives on the Board of NorthLink Orkney and Shetland Ferries Limited.

Relations with Sole Shareholder

As disclosed in the Report of the Directors, the Company's sole shareholder, the Scottish Ministers, is considered to be a Shadow Director of the Company.

The Scottish Ministers' appointed Assessor attends all Board Meetings.

Internal Control

The Board is responsible for the Company's system of internal control and for reviewing its effectiveness in order to safeguard the Shareholder's investment and the Company's assets. The system is designed to provide reasonable but not absolute assurance against material mis-statement or loss.

In accordance with guidance issued in the document "Internal Control: Guidance for Directors on the Combined Code" which was published in September 1999 (the Turnbull guidance) procedures are in place to ensure that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Company, which is subject to regular review by the Board and Audit Committee. These procedures have been in place throughout this financial year and up to the date of approval of the Annual Report and Accounts.

The key elements of the system of internal control are as follows:

Control Environment

The Company's control environment is the responsibility of the Directors and Managers at all levels. The Company's organisational structure has clear lines of responsibility and effective communication channels which ensures that best practice in managing risks and controls is consistently applied throughout the Company.

In addition, the Company's internal and external auditors present reports to the Audit Committee which include any significant internal control matters which they have identified.

Identification and Monitoring of Business Risks

The Company has adopted a risk-based approach to internal control through evaluating the likelihood and impact of risks, and resting responsibility for risk management and internal control in a designated owner. Procedures include an ongoing process of identifying, evaluating and managing the Company's key risks and, where appropriate, enhancing the systems which manage these risks. Regular review of the risks is undertaken by the Board and the Audit Committee.

Major Corporate Information Systems

The Company operates a comprehensive budgeting and financial reporting system, which includes the preparation of a three year strategic plan with a detailed annual budget.

The system provides monthly comparison of actual results with budget, regularly revised forecasts, balance sheet, cash flow and variance statements and key performance indicators, all of which are regularly reviewed by the Board.

Standard financial control procedures operate throughout the Company to provide assurance on the integrity of the Company's finances, including established procedures for *inter alia* the authorisation of capital expenditure.

Going Concern

On the basis of the information available to them, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

Statement of Directors' Responsibilities

Company law requires the Directors to prepare Accounts for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss for that year. In preparing those Accounts, the Directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable and prudent
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Accounts; and
- prepare the Accounts on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the Accounts comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Statement of Auditor's Responsibilities

The Company's registered auditor, KPMG LLP, is responsible for forming an independent opinion on the Accounts of the Company as presented by the Directors and for reporting its opinion to the Company's members. The Independent Auditor's Report to the Members of Caledonian MacBrayne Limited is set out on page 22.

Report on Remuneration Matters

Details of the Remuneration Committee's responsibilities are set out within the Report of Corporate Governance. Details of Directors' Remuneration are as follows.

Directors' Remuneration

	Salary	Fees	Performance Payment	Benefits in kind*	Total 2005	Total 2004	Employer's Pension Contribution 2005	Employer's Pension Contribution 2004
	£000	£000	£000	£000	£000	£000	£000	£000
Executive Directors								
L Sinclair	91	-	8	8	**107**	108	**13**	13
A M Lynch	63	-	6	5	**74**	72	**8**	8
J Kerr (appointed during year)	39	-	5	5	**49**	-	-	-
P G Preston (appointed during year)	38	-	4	3	**45**	-	**5**	-
Non-Executive Directors								
Dr H H Mills	-	25	-	-	**25**	25	-	
S Grier	-	7	-	-	**7**	7	-	
J A Macpherson	-	7	-	-	**7**	7	-	
A A MacDonald	-	7	-	-	**7**	7	-	
J A Nicolson	-	7	-	-	**7**	7	-	
Professor P K Timms	-	7	-	-	**7**	7	-	
Retired/Resigned								
K Hayes	-	-	-	-	-	38	-	-
T C McNeill	64	-	-	7	**71**	84	**6**	10
W A C Thomson	-	2	-	-	**2**	7	-	-
	295	62	23	28	**408**	369	**32**	31

* The principal benefit in kind relates to the provision of a fully expensed car.

Pensions

Executive Directors are entitled to be members of the Company's pension scheme.

The Company scheme (to which each member currently contributes 5.25%) entitles members to a pension on retirement based on their Final Pensionable Salary which reflects the highest salary in each of the last five years of pensionable service.

The financial effect of the pension arrangements for present Directors who were members of the Company's pension scheme during the year is as follows:

	Annual Pension payable from normal retirement date based on service and salary at March 2005	2004	After taking account of inflation during the year, the increase in annual pension is 2005	2004	The cost to the pension scheme (transfer value) of the increase in annual pension is 2005	2004	Transfer value based on accrued pension 2005	2004
	£000	£000	£000	£000	£000	£000	£000	£000
L Sinclair	**6**	4	**2**	2	**26**	23	**89**	58
A M Lynch	**3**	1	**1**	1	**11**	8	**27**	14
P G Preston	**13**	-	**3**	-	**30**	-	**129**	-
T C McNeill	**13**	11	**2**	1	**30**	22	**220**	188

Allowance has been made in the above for the contributions made by Directors. Normal retirement age for Executive Directors is 65. The accrued pension and transfer value disclosed in respect of T C McNeill, who retired during the year, are based on the pension in payment at 31 March 2005; no tax-free payment was taken on retirement. J Kerr joined the pension scheme in April 2005.

Service Contracts of Executive Directors

The terms of appointment of present Directors are as follows:

	Term	Notice of termination By the Company	By the Director
L Sinclair	3 year fixed term renewable	3 months	3 months
J Kerr	3 year fixed term renewable	3 months	3 months
A M Lynch	3 year fixed term renewable	3 months	3 months
P G Preston	3 year fixed term renewable	3 months	3 months

Report of the Independent Auditors to the Members of Caledonian MacBrayne Limited

We have audited the Accounts on pages 23 to 36.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors are responsible for preparing the Annual Report. As described on page 20, this includes responsibility for preparing the accounts in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, and by our profession's ethical guidance.

We report to you our opinion as to whether the accounts give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the accounts, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit or if information specified by law regarding Directors' remuneration and transactions with the Company is not disclosed.

In addition to our audit of the financial statements, the Directors have engaged us to review their corporate governance statements as if the Company were required to comply with the Listing Rules of the Financial Services Authority in relation to these matters. We review whether the statement on page 17 reflects the Company's compliance with the nine provisions of the 2003 FRC Code specified for our review by those rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited accounts. We consider the implications for our report if we become aware of any apparent mis-statement or material inconsistencies with the accounts.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or other irregularity or error.

In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Accounts.

Opinion

In our opinion the Accounts give a true and fair view of the state of the Company's affairs as at 31 March 2005 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG LLP

KPMG LLP
Chartered Accountants
Registered Auditor
191 West George Street
GLASGOW
G2 2LJ
20 July 2005

Profit and Loss Account for the year ended 31 March 2005

	Note	2005 £000	2005 £000	2004 £000	2004 £000
Turnover	2		**76,179**		73,047
Total Operating Expenditure			**74,517**		71,351
Operating Profit			**1,662**		1,696
Interest Receivable		330		199	
Interest Payable	3	(1,187)		(1,118)	
			(857)		(919)
Profit on Ordinary Activities before Taxation	3		805		777
Taxation	4		(261)		(222)
Profit for the Financial Year	15		544		555

There were no recognised gains or losses for the years ended 31 March 2005 and 31 March 2004 other than those shown above.

The Notes on pages 26 to 36 form part of these Accounts

Balance Sheet as at 31 March 2005

	Note	2005 £000	2005 £000	2004 £000	2004 £000
Fixed Assets					
Tangible Assets	6	**99,459**		94,714	
Investments	7	**750**		750	
			100,209		95,464
Current Assets					
Stocks of fuel, lubricants and consumables		**771**		716	
Debtors and prepayments	8	**5,997**		6,426	
Cash at bank and in hand		**11,031**		8,989	
		17,799		16,131	
Creditors					
Amounts falling due within one year	9	**(12,903)**		(12,349)	
Net Current Assets			**4,896**		3,782
Total Assets less Current Liabilities			***105,105***		*99,246*
Creditors					
Amounts falling due after more than one year	10	**(24,579)**		(19,447)	
Accruals and Deferred Income					
Capital Grants	12	**(50,968)**		(51,046)	
Provisions for Liabilities and Charges	13	***(6,656)***		*(6,395)*	
			(82,203)		(76,888)
Net Assets			**22,902**		22,358
Capital and Reserves					
Called up Share Capital	14	**15,000**		15,000	
Capital Reserve	15	**3,300**		3,300	
Profit and Loss Account	15	**4,602**		4,058	
Shareholder Funds – All Equity	15		**22,902**		22,358

These Accounts were approved by the Board of Directors and signed on 20 July 2005 on its behalf by:

Howard H Mills

Dr H H Mills, Chairman

Alex Lynch

A M Lynch, Finance Director

The Notes on pages 26 to 36 form part of these Accounts

Cash Flow Statement for the year ended 31 March 2005

	Note	2005 £000	2005 £000	2004 £000	2004 £000
Net cash inflow from Operating Activities	18(a)		**4,251**		3,595
Returns on Investments and Servicing of Finance					
Interest received		**321**		194	
Interest paid		**(1,122)**		(1,119)	
Net cash outflow from returns on Investments and Servicing of Finance			**(801)**		(925)
Taxation					
UK Tax received			**-**		329
Capital Expenditure					
Payments to acquire tangible fixed assets		**(9,256)**		(4,369)	
Receipts from sales of tangible fixed assets		**100**		1	
Capital grants received		**2,480**		978	
Net cash outflow from Capital Expenditure			**(6,676)**		(3,390)
Net cash outflow before Financing			**(3,226)**		(391)
Financing					
Loans received		**6,353**		2,677	
Loans repaid		**(1,085)**		(852)	
Net cash inflow from Financing			**5,268**		1,825
Increase in cash			**2,042**		1,434

Reconciliation of net cash flow to movement in Net Debt

		2005 £000	2004 £000
Increase in cash		**2,042**	1,434
Net movement on loans		**(5,268)**	(1,825)
Movement in net debt in the period		**(3,226)**	(391)
Net debt at 1 April		**(11,546)**	(11,155)
Net debt at 31 March	18(b)	**(14,772)**	(11,546)

Notes on the Accounts

1. Accounting Policies

(a) Basis of Preparation

These accounts have been prepared under the historical cost accounting convention and in accordance with applicable accounting standards. A summary of the more important accounting policies, which have been applied consistently, is set out below.

(b) Tangible Assets

Gross book values of all tangible assets are stated at cost. Ships and other assets including linkspans under construction are recorded at cost on the basis of payments to account. No depreciation is charged until the asset comes into use.

Information technology systems equipment is expensed in the year of purchase.

(c) Investments

Fixed asset investments are carried at cost.

(d) Depreciation

No depreciation is provided on freehold land. Depreciation is provided on other tangible assets by equal annual instalments calculated to write off the cost (taking account of anticipated residual values) over their estimated useful lives as follows:

Buildings (Freehold)	40 years
Buildings (Leasehold)	The shorter of the term of the lease and 40 years
Piers Slipways and Linkspan facilities	40 years
Ships	25 years
Vehicles	Between 4 and 5 years
Plant and equipment	Between 3 and 10 years

(e) Capital Grants

Capital grants are deferred and taken to the Profit and Loss Account over the anticipated lives of the relevant assets.

(f) Stock

Stock is valued at the lower of average invoiced cost and net realisable value.

(g) Annual Overhauls

Overhaul costs are charged to the profit and loss account in the period in which the overhaul is performed.

(h) Taxation

The charge for taxation is based upon the result for the year and takes into account tax deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. The Directors have chosen not to discount the Company's deferred tax liability, as permitted by FRS19.

(i) Pensions

The Company operates a defined benefit scheme and participates in certain other defined benefit pension schemes. Contributions are charged to the profit and loss account so as to spread the cost of pensions over the employees' working lives within the Company.

(j) Derivatives and financial instruments

The Company has adopted FRS 13: Derivatives and other financial instruments. The Company's financial instruments comprise borrowings, cash and other liquid resources and various items such as trade debtors and creditors that arise directly from operations. All of the Company's borrowings are fixed rate liabilities. The Company's policy is not to trade or speculate in financial instruments but to utilise them to finance operations.

(k) Receipts in advance

Receipts for advanced and multi-journey bookings are recognised with reference to time of travel. The deferred element of this income is shown under Creditors.

2. Turnover

Turnover represents gross revenue stated net of value added tax and is made up as follows:

	2005 £000	2004 £000
Fares and charges	**49,868**	46,717
Deficit grant received from the Scottish Executive	**25,900**	25,919
Subsidy received from the Northern Ireland Department for Regional Development	**411**	411
	76,179	73,047

Notes on the Accounts continued

3. Profit on Ordinary Activities before Tax

The Profit is stated after charging/(crediting):	2005 £000	2004 £000
Auditors' remuneration – audit services	**37**	36
– other services	**71**	88
Depreciation of Tangible Fixed Assets	**4,511**	4,332
Staff Costs (note 5)	**40,074**	37,607
Interest payable - loans	**1,187**	1,118
Operating lease costs - land and buildings	**243**	207
- motor vehicles	**142**	140
Release of capital grants (note 12)	**(2,517)**	(2,510)
Net gain on disposal of tangible assets	**(100)**	(1)

Analysis of turnover and expenditure is set out on page 13.

4. Taxation

The tax charge for the year is made up as follows:	2005 £000	2004 £000
Corporation Tax		
UK corporation tax on profit for the period at 30% (2004: 30%)	**-**	-
Deferred Tax		
Originating and reversal of timing difference	**257**	247
Adjustments in respect of prior years	**4**	(25)
Total deferred tax	**261**	222
Tax on profit on ordinary activities	**261**	222

The tax assessed for the period is lower (2004: lower) than the standard rate of corporation tax of 30% (2004: 30%).

The differences are explained below:

Profit on ordinary activities before tax	**805**	777
UK corporation tax at 30% (2004:30%)	**242**	233
Effects of:		
Expenses not deductible for tax purposes	**18**	17
Current deferred tax charge	**(257)**	(247)
Other	**(3)**	(3)
Corporation tax for the year	**-**	-

5. Employee Information

Staff Costs (including Directors)

	2005 £000	2004 £000
Wages and Salaries	**29,213**	27,284
Social Security Costs	**2,852**	2,668
Other Pension Costs (note 16)	**4,641**	3,839
	36,706	33,791
Staff-related Costs	***3,368***	*3,816*
	40,074	37,607

Details of Directors' remuneration are given on page 21.

Employee numbers
The average number of employees, including Directors, was made up as follows:

	2005 No.	2004 No.
Ship Operating	**787**	772
Shore Terminal	**263**	236
Administrative	**115**	112
	1,165	1,120

Central ship repair staff and reservations staff are treated as Ship Operating and Shore Terminal staff respectively.

Notes on the Accounts continued

6. Tangible Assets

(a) Movements during year:

	Assets in course of construction £000	Land and Buildings £000	Ships £000	Vehicles £000	Plant and Equipment £000	Total £000
At Cost:						
At 31 March 2004	2,086	33,819	123,191	359	2,915	162,370
Additions	9,238	18	-	-	-	9,256
Disposals	-	(304)	(1,315)	(8)	-	(1,627)
At 31 March 2005	**11,324**	**33,533**	**121,876**	**351**	**2,915**	**169,999**
Aggregate Depreciation:						
At 31 March 2004	-	12,427	52,453	335	2,441	67,656
Charge for the year	-	890	3,379	13	229	4,511
Disposals	-	(304)	(1,315)	(8)	-	(1,627)
At 31 March 2005	**-**	**13,013**	**54,517**	**340**	**2,670**	**70,540**
Net Book Value at 31 March 2005	**11,324**	**20,520**	**67,359**	**11**	**245**	**99,459**
Net Book Value at 31 March 2004	2,086	21,392	70,735	24	474	94,714

Land and Buildings is made up as follows:

	Land £000	Buildings: Freehold £000	Buildings: Long Lease £000	Buildings: Short Lease £000	Piers Slipways & Linkspan Facilities £000	Total £000
At Cost:						
At 31 March 2004	356	2,721	139	1,166	29,437	33,819
Additions	-	9	-	-	9	18
Disposals	-	(183)	-	(84)	(37)	(304)
At 31 March 2005	**356**	**2,547**	**139**	**1,082**	**29,409**	**33,533**
Aggregate Depreciation:						
At 31 March 2004	-	1,185	54	1,007	10,181	12,427
Charge for the year	-	123	3	16	748	890
Disposals	-	(183)	-	(84)	(37)	(304)
At 31 March 2005	**-**	**1,125**	**57**	**939**	**10,892**	**13,013**
Net Book Value at 31 March 2005	**356**	**1,422**	**82**	**143**	**18,517**	**20,520**
Net Book Value at 31 March 2004	356	1,536	85	159	19,256	21,392

The majority of the assets in course of construction at 31 March 2005 have subsequently been completed.

Piers, slipways and linkspan facilities comprise properties which are erected partially on freehold land and partially on seabed leased from the Crown Estate Commissioners. Because of the integral nature of these assets, it is not possible or meaningful to allocate their costs between those parts erected on freehold land and those on leased seabed. The Company may come under liability, as tenants, for removal of the assets at termination of the leases. The extent to which any such liability may arise cannot be determined and no provision or security has been provided.

(b) Capital Commitments

	2005 £000	2004 £000
No provision has been made in these Accounts for outstanding Capital Commitments contracted for amounting to:	**2,812**	10,777
Capital Grants receivable in respect of these commitments amount to:	**444**	2,167

7. Investments

	Joint venture £000	Subsidiary Undertaking £000	Long term indebtedness £000	Total £000
At 31 March 2004 and 31 March 2005 at cost	**750**	**74**	**(74)**	**750**

The Company owns the whole of the ordinary share capital of Caledonian MacBrayne Holdings Limited, a dormant company registered in Scotland.

The Company beneficially owns 50% of the £1.5 million equity share capital of NorthLink Orkney & Shetland Ferries Limited ('NorthLink') which, under contract with the Scottish Executive, operates ferry services between the Scottish mainland and Orkney and Shetland. In accordance with the associated joint venture agreement, the equity shares are held by the Royal Bank of Scotland plc as security trustee for and on behalf of the Company in respect of the performance of certain leasing obligations entered into between NorthLink and a subsidiary of the Royal Bank of Scotland plc.

NorthLink prepares its accounts to 30 September; summary financial statements extracted from the audited accounts, showing the Company's proportionate 50% share of the result for the years to 30 September 2003 and 30 September 2004 and the balance sheet as at these dates, are as follows:

Profit and loss account for the year ended 30 September 2004

	2004 £000	2003 £000
Turnover	16,721	14,459
Operating Expenditure (including exceptional items of £516,000 (2003: nil))	(22,475)	(17,568)
Gross loss	(5,754)	(3,109)
Exceptional other operating income	7,535	2,750
Operating profit/(loss)	1,781	(359)
Interest receivable	17	-
Interest payable	(258)	(235)
Profit/(Loss) on ordinary activities before taxation	1,540	(594)
Taxation	(1)	(2)
Profit/(Loss) for the Financial Year	1,539	(596)

Balance sheet as at 30 September 2004

	£000	2004 £000	£000	2003 £000
Tangible Assets	-		825	
Intangible Assets	-		573	
		-		1,398
Current Assets				
Stocks	172		145	
Debtors and Prepayments	2,832		3,045	
Cash and Bank	147		432	
	3,151		3,622	
Creditors				
Amounts falling due within one year	(1,570)		(4,291)	
Net Current Assets/(Liabilities)		1,581		(669)
Total assets less current liabilities		1,581		729
Creditors				
Amounts falling due after more than one year		-		(687)
Net assets attributable to the Company		1,581		42
Represented by:				
Share capital		750		750
Profit and loss account		831		(708)
Equity Shareholders' Funds attributable to the Company		1,581		42

NorthLink's management accounts to the end of the initial contract period, 31 May 2005, indicate that Shareholders' funds attributable to Caledonian MacBrayne continue to exceed the original investment. The projected accounts to the end of the second contract period, 30 November 2005, indicate that the position regarding Shareholders' funds will at least be maintained.

On the basis of all the information available to them, the Directors of Caledonian MacBrayne are of the opinion that the investment should be held at £750,000.

8. Debtors and prepayments

	2005 £000	2004 £000
Trade debtors	1,907	2,131
Other debtors	1,317	1,658
Prepayments and accrued income	2,147	1,436
Capital Grants receivable	594	635
Amounts due from NorthLink	32	566
	5,997	6,426

9. Creditors: amounts falling due within one year

	2005 £000	2004 £000
Loans (note 10)	1,224	1,088
Trade creditors	4,568	5,130
Tax and social security payments	-	812
Other creditors and accruals	4,600	3,773
Deferred income	2,509	1,531
Amounts due to NorthLink	2	15
	12,903	12,349

10. Creditors: amounts falling due after more than one year

	2005 £000	2004 £000
8.567% unsecured loan not wholly repayable within five years, repayable in half-yearly instalments	2,002	2,192
8.421% unsecured loan not wholly repayable within five years, repayable in half-yearly instalments	156	169
7.75% unsecured loan not wholly repayable within five years, repayable in half-yearly instalments	443	478
6% unsecured loan not wholly repayable within five years, repayable in half-yearly instalments	2,554	2,743
5.25% unsecured loan not wholly repayable within five years, repayable in half-yearly instalments	3,036	3,226
4.927% unsecured loan not wholly repayable within five years, repayable in half-yearly instalments	6,687	6,954
4.933% unsecured loan not wholly repayable within five years, repayable in half-yearly instalments	4,519	4,711
4.75% unsecured loan not wholly repayable within five years, repayable in half-yearly instalments (see note below*)	6,406	62
	25,803	20,535
Less: Repayable within twelve months (note 9)	(1,224)	(1,088)
	24,579	19,447
Instalments on the loans included above are repayable as follows:		
between one and two years	1,350	1,089
between two and five years	4,054	3,265
after five years	19,175	15,093
	24,579	19,447

*This loan relates to a vessel under construction at 31 March 2005 and the loan has not yet been converted to a term loan; the Directors' best estimate of the rate which will be applied on conversion is as shown.

Notes on the Accounts continued

11. Derivatives and Financial Instruments

(a) Short term debtors and creditors
As permitted by FRS 13, short term debtors and creditors have been excluded from all of the following disclosures.

(b) Interest rate risk profile and financial liabilities and assets
The interest rate profile of the Company's financial liabilities was as follows:

Currency	**Total**		**Floating rate**		**Fixed rate**		**Weighted average interest rate**		**Weighted average period until maturity**	
Sterling	**2005 £000**	2004 £000	**2005 £000**	2004 £000	**2005 £000**	2004 £000	**2005 %**	2004 %	**2005 Years**	2004 Years
Loans	**25,803**	20,535	**-**	-	**25,803**	20,535	5.38	6.21	**18**	18
Cash	**(11,031)**	(8,989)	**-**	-	**-**	-	**-**	-		
Net borrowing	**14,772**	11,546	**-**	-	**25,803**	20,535	**5.38**	6.21	**18**	18

All of the Company's borrowings are at fixed rates of interest. The fair value of these loans at 31 March 2005, ascertained through discounting the future cash flows at the official National Loans Fund rate, was £26,698,000 (2004: £21,879,000).

(c) Liquidity risk
The maturity profile of the Company's financial liabilities, excluding short term creditors and the undrawn facilities available to the Company in respect of which all conditions precedent had been met, are as follows:

	Drawn £000	**Undrawn £000**	**Total facilities £000**
Expiring within one year or less	1,224	500	1,724
Expiring between one and two years	1,350	-	1,350
Expiring in more than two years	23,229	-	23,229
	25,803	**500**	**26,303**

For all debt, short term assets and liabilities, the book values and fair values are the same except for fixed rate borrowings where the fair value is detailed above.

The Company does not have any significant foreign currency exposure, nor does it speculate in derivative transactions.

12. Capital Grants	**2005 £000**	2004 £000
Balance at 1 April	**51,046**	52,658
Grants received and receivable	**2,439**	898
Less: released to Profit and Loss Account	**(2,517)**	(2,510)
Balance at 31 March	**50,968**	51,046

13. Provisions for liabilities and charges

Deferred Tax

The movement on the deferred tax balance during the year is as follows:

	2005 £000	2004 £000
Balance at 1 April	**6,395**	6,173
Charge in the year	**257**	247
Adjustment in respect of prior years	**4**	(25)
Balance at 31 March	**6,656**	6,395
The main components of deferred tax at 30% (2004: 30%) are:		
Accelerated capital allowances	**6,861**	6,451
Other timing differences	**(205)**	(56)
Balance at 31 March	**6,656**	6,395

14. Share Capital

	2005 £000	2004 £000
Authorised allotted issued and fully paid – 1.5 million ordinary shares of £10 each	**15,000**	15,000

15. Reconciliation of movement in Shareholder's Funds

	Share Capital £000	Capital Reserve £000	Profit & Loss Account £000	Total Shareholder's Funds £000
Balance at beginning of year	15,000	3,300	4,058	22,358
Profit for the financial year	-	-	544	544
Balance at end of year	***15,000***	***3,300***	***4,602***	***22,902***

Notes on the Accounts continued

16. Pension Arrangements

The amount charged to profit and loss account in respect of employer contributions to Pension Schemes is:

		2005 £000	2004 £000
Company scheme	– ongoing contributions	**1,656**	1,541
	– contributions toward past deficits	**1,700**	1,450
Other schemes	– ongoing contributions	**478**	495
	– contributions towards past deficits	**807**	353
		4,641	3,839

The following amount which represents normal contributions to be paid to Pension Schemes is included in Creditors:

	2005 £000	2004 £000
	-	**180**

The employer and employee contributions relating to March 2005 were paid to the respective Pension Schemes prior to 31 March 2005.

Company defined benefit scheme

The Company operates a contributory defined benefit pension scheme providing benefits based upon final pensionable salary. The assets of the scheme are held in a separate trustee-administered fund. Contributions are charged to the profit and loss account so as to spread the cost of pensions over the employees' working lives with the Company and are assessed by a qualified actuary on the basis of triennial valuations, using the projected unit method.

The pension cost figures used in these accounts comply with the current pension cost accounting standard SSAP24. The most recent full actuarial valuation was undertaken as at 6 April 2004. The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments and the rate of increase in salaries and pensions. It was assumed that present and future pensions in payment would increase at the rate of 3% per annum and pensionable pay would increase at the rate of 4.5% per annum. Based on the Fund's liability profile, it was further assumed that investments would grow at the rate of 7.5% per annum in the period before retirement, reducing to 5.5% per annum for the period after retirement.

The valuation showed that the market value of assets was £27.7 million and that this represented 81% of the value of the benefits which had accrued to members, taking account of projected pensionable pay. In order to assist the funding of the deficit, the Company made a special payment into the fund of £1.7m (£1.5m was paid before 31 March 2005 and the remainder was paid in July 2005). The Scheme actuary concluded that the ongoing contribution rate of 17.6%, which is inclusive of employee contributions and the cost of insuring death-in-service benefits and assumes that all age-related National Insurance rebates received from the DWP will be credited directly to and retained by the fund, is insufficient to restore the long-term ongoing funding level to 100% within the required timescales. The Board, guided by the Trustees of the Pension Scheme and actuarial recommendation, agreed that the contribution rate should be increased to 19.75% with effect from 1 April 2005. The next full actuarial valuation will be undertaken as at 6 April 2007.

The transitional arrangements of FRS17 require disclosure of assets and liabilities as at 31 March 2005 to be calculated in accordance with the requirements of FRS17. Under the transitional arrangements, the resultant figures are illustrative only and do not impact on the actual balance sheet.

The full actuarial valuation of the pension scheme, carried out as at 6 April 2004, formed the basis of the undernoted FRS17 disclosures at 31 March 2005 and 2004, prepared by a qualified independent actuary (the disclosure for 2003 was based on the full actuarial valuation carried out as at 6 April 2001 updated on an FRS17 basis). The major assumptions used were as follows:

	2005 %	2004 %	2003 %
Rate of increase in salaries	**4.0**	4.0	4.0
Rate of increase in pensions in payment	**2.9**	2.8	2.5
Rate of increase in deferred pensions	**2.9**	2.8	2.5
Rate of discount	**5.4**	5.5	5.5
Inflation assumption	**2.9**	2.8	2.5

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale concerned, may not necessarily be borne out in practice.

16. Pension Arrangements (continued)

The fair value of the scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the scheme's liabilities, which are derived from cash flow projections over long periods and are thus inherently uncertain, together with the relevant expected long term rates of return, were as follows:

	2005		2004		2003	
	%	**£000**	%	£000	%	£000
Equities (including Property)	**7.75**	**21,984**	8.0	18,022	8.5	16,138
Bonds	**5.4**	**4,733**	5.5	3,901	5.5	484
Gilts (including Cash)	**4.75**	**6,064**	4.75	4,643	4.5	3,233
Total market value of assets		**32,781**		26,566		19,855
Present value of scheme liabilities		**(43,488)**		(38,496)		(32,649)
Deficit in the Scheme		**(10,707)**		(11,930)		(12,794)
Related deferred tax asset @ 30%		**3,212**		3,579		3,838
Net pension liability		**(7,495)**		(8,351)		(8,956)

The amount of this pension liability would have a consequential effect on reserves had FRS17 been fully implemented at 31 March 2005. In addition, *the following information would have been included:*

Movements in Deficit During the Year	**2005**	2004
	£000	£000
Deficit in scheme at beginning of the year	**(11,930)**	(12,794)
Movement in year:		
Current service cost	**(2,190)**	(1,726)
Contributions - ongoing	**1,791**	1,541
- age-related rebate	**360**	361
- *special contribution to past service costs*	**1,650**	1,300
Other finance costs	**(173)**	(182)
Actuarial loss	**(215)**	(430)
Deficit in scheme at the end of the year	**(10,707)**	(11,930)

Analysis of Amount Charged to Operating Profit	**2005**	2004
	£000	£000
Current service cost	**2,190**	1,726
Past service cost	**-**	-
Total operating charge	2,190	1,726

Analysis of Amount Credited to Other Financial Income	**2005**	2004
	£000	£000
Expected return on pension scheme assets	**1,980**	1,643
Interest cost	**(2,153)**	(1,825)
Net charge	(173)	(182)

Analysis of Amount Recognised in Statement of Total Recognised Gains and Losses (STRGL)

	2005	2004	2003
	£000	£000	£000
Actual return less expected return on scheme assets	**1,316**	2,512	(7,554)
Experience gains and losses arising on scheme liabilities	**(178)**	(1,708)	(998)
Changes in financial assumptions underlying scheme liabilities	**(1,353)**	(1,234)	(1,406)
Actuarial loss recognised in STRGL	**(215)**	(430)	(9,958)

History of actuarial gains and losses	**2005**	2004	2003
	%	%	%
Actual return less expected return on scheme assets expressed as a percentage of scheme assets	**4.0**	9.5	(38.0)
Experienced gains and losses arising on scheme liabilities expressed as a percentage of the present value of scheme liabilities	**(0.4)**	(4.4)	(3.0)
Changes in assumptions underlying scheme liabilities expressed as a percentage of the present value of scheme liabilities	**(3.1)**	(3.2)	(4.3)
Total actuarial loss recognised in the statement of total recognised gains and losses expressed as a percentage of the present value of scheme liabilities	**(0.5)**	(1.1)	(30.5)

The measurement bases required by FRS17 are likely to give rise to significant fluctuations in the reported amounts of the defined pension scheme's assets and liabilities from year to year, and do not necessarily give rise to a change in the contributions payable into the scheme which is recommended by the independent actuary based on the expected long term rate of return on the scheme's assets.

Notes on the Accounts continued

16. Pension Arrangements (continued)

Other Pension Schemes

A number of employees are not members of the Company pension scheme. Most of them participate in one of the Merchant Navy Pension Funds.

The Merchant Navy Officers' Pension Fund (MNOPF) and the Merchant Navy Ratings' Pension Fund (MNRPF) are both industry-wide defined benefit pension schemes.

The MNOPF is closed to new members and the latest valuation was carried out as at 31 March 2003 and signed on 25 March 2004. The scheme's independent actuary advised that the market value of the scheme's assets for the pre-1978 section of the scheme represented approximately 115% of benefits accrued to members and, for the post-1978 section of the scheme, 86% of the value of the benefits accrued to members allowing for future increases in earnings. Since those valuations were obtained, the MNOPF Trustee has made an application to the Court to determine which of the employers who have ever contributed to the MNOPF remain participating employers who can be asked to contribute towards the deficit in the post-1978 section and has also undertaken provisional calculations to apportion the deficit between employers. The Court action was completed during 2005 and the Trustee will be making final decisions concerning any contributions required towards the deficit.

The Trustees of the MNOPF cannot identify the underlying assets held in the Fund in respect of the Company's liabilities. Accordingly, for FRS 17 purposes, the Company is accounting for contributions and payments to the MNOPF as if it were a defined contribution scheme.

The MNRPF is a closed scheme and the latest full triennial actuarial valuation as at 31 March 2002, carried out by an independent actuary, showed that the scheme had exceeded its minimum funding requirement at that date, but was still in deficit on an ongoing basis. The valuation showed that the market value of assets was 84% of the value of benefits accruing to members allowing for future increases. As a result of this valuation, a revised fixed schedule of payments has been drawn up which remains in place until 31 March 2007. Under this schedule the Company is obliged to make annual contributions in respect of which the amounts payable during the current and previous financial years are shown earlier in this note under 'Other schemes – contributions towards past deficits'. The amounts payable by the Company in respect of past deficits are determined, to some extent, by the level of contributions made by other participating employers and may therefore fluctuate from year to year. The next full actuarial valuation will be undertaken as at 31 March 2005, the results of which are not expected to be available until early 2006.

The Trustees of the MNRPF cannot identify the underlying assets held in the fund in respect of the Company's liabilities. Accordingly, for FRS 17 purposes, the Company is accounting for contributions and payments to the MNRPF as if it were a defined contribution scheme.

The Merchant Navy Officers' Pension Plan and the Merchant Navy Ratings Pension Plan are both industry-wide defined contribution pension schemes and, as a result, do not have deficits. The running costs of both Plans are met by an offset against the Employers' pension contribution which is regularly reviewed. The balance of the pension contribution paid by employers and employees is invested in accordance with the instructions of members, to provide defined contribution benefits.

Although the overall funding deficits and the full implications for participating employers in relation to the Merchant Navy schemes have still to be confirmed, it is anticipated that the Company's share of such deficits will be met through future Government deficit grant funding.

17. *Other Financial Commitments*

The Company has a number of operating leases in respect of land and buildings and the period of the lease unexpired in most cases is in excess of 5 years; where less than 5 years remains, the Company will negotiate a renewal of the lease at expiry date. The annual commitment in respect of these leases is £207,000 (2004: £219,000).

The Company also has a number of operating leases in respect of motor vehicles. The annual commitments in respect of these leases are as follows:

	2005 £000	2004 £000
Leases which expire:		
within one year	**26**	12
between two and five years	**67**	95
	93	107

18. Notes to the Cash Flow Statement

(a) Reconciliation of operating profit to net cash inflow from operating activities

	2005 £000	2004 £000
Operating profit	**1,662**	1,696
Depreciation charge (net of capital grants)	**1,994**	1,822
Gain on disposal of tangible assets	**(100)**	(1)
Increase in stocks	**(55)**	(87)
Decrease/(Increase) in debtors and prepayments	**398**	(1,548)
Increase in creditors	**352**	1,713
Net cash inflow from operating activities	**4,251**	3,595

(b) Analysis of Net Debt

	As at 31 March 2004 £000	Cash Flow £000	**As at 31 March 2005 £000**
Cash at bank and in hand	8,989	2,042	**11,031**
Loans:			
Due within one year	(1,088)	(136)	**(1,224)**
Due after one year	(19,447)	(5,132)	**(24,579)**
	(20,535)	(5,268)	**(25,803)**
Total	(11,546)	(3,226)	**(14,772)**

19. Related party transactions

The Scottish Ministers are the Company's sole shareholder.

Details of transactions with the Scottish Ministers are as follows:	**2005 £000**	2004 £000
Deficit Grant received	**25,900**	25,919
Capital Grants received and receivable	**2,439**	898
Loans received	**6,353**	2,677
Loans repaid	**1,085**	852
Interest paid and payable	**1,187**	1,118
Balance of loans due at 31 March	**25,803**	20,535

The Company is contracted to provide technical support , ship management and interim management and administrative services to NorthLink in return for which the Company receives fees and reimbursement of expenses. The fees, net of value added tax, in respect of the year ended 31 March 2005, amounted to £374,000 (2004: £333,000).

In addition, the Company chartered a vessel to NorthLink to enable NorthLink to cover the NorthLink vessel overhaul programme. The charter fees in respect of the financial period to 31 March 2005 amounted to £208,000 (2004: £344,000). The charter was contracted under industry standard terms and conditions on an arms length basis. The total amount outstanding from NorthLink at 31 March 2005 was £32,000 (2004: £566,000).

The Company is due £2,000 (2004: £15,000) to NorthLink in respect of ticket sales.

The respective amounts due to and from NorthLink at 31 March 2005 have subsequently been settled.

Professional Advisers

Auditors	KPMG LLP 191 West George Street Glasgow G2 2LJ
Solicitors	McGrigors Pacific House 70 Wellington Street Glasgow G2 6SB
Bankers	The Royal Bank of Scotland **plc** 8/10 Gordon Street Glasgow G1 3PL Girobank 93 George Street Edinburgh EH2 3JL
Principal Insurers	The North of England Protecting & Indemnity Association and Marine Shipping Mutual Insurance The Quayside, Newcastle-Upon-Tyne NE1 3DU

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