Acorn Income Fund Limited

managed by Collins Stewart Fund Management Limited

Report and Financial Statements 2005

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Investment Objectives and Policy

OBJECTIVES

The objectives of Acorn Income Fund Limited (the "Company") are to provide Shareholders with a high income and also the opportunity for capital growth.

POLICY

The Company's portfolio is invested in equities and high income and fixed interest securities in order to achieve its investment objectives. It is the aim of the Company to provide both income and capital growth predominantly through investment of approximately 75% of the portfolio in smaller capitalised United Kingdom companies admitted to the Official List of the United Kingdom Listing Authority and traded on the London Stock Exchange or traded on AIM. The Company also aims to further enhance income for Shareholders by investing approximately 25% of its assets in a Sterling denominated investment grade fixed interest bond portfolio. Due to the recent performance of the Smaller Companies Portfolio and the testing conditions faced by the Sterling bond market the split has been relaxed to be closer to 80% invested in smaller capitalised United Kingdom companies, whilst the remainder is invested in Sterling denominated investment grade fixed interest bonds and cash.

As at 31 December 2005, Acorn Income Fund Limited held £961,066 (2004: £744,550) in ordinary shares and income shares of split capital investment trusts acquired before the change in investment policy. It is intended that these holdings will gradually be disposed of, as advised by the Investment Adviser from time to time, and the proceeds re-invested in accordance with the new investment policy.

A closed-end investment company, incorporated under The Companies (Guernsey) Law, 1994.

REGISTERED IN GUERNSEY No. 34778

Chairman's Statement

I am pleased to present to Shareholders the Report and Financial Statements of Acorn Income Fund Limited, (the "Company") for the year ended 31 December 2005.

During the year under review the Company increased its net asset value per share[1] by 35.26 pence, after distributing dividends totalling 9.00 pence per share, and achieved a total return per share of 44.26 pence. This represents a total annual return of 31.96% based upon the opening net asset value per share, outperforming our benchmark. Since 31 December 2005 the net asset value per share[1] has continued to rise, reaching 194.04 pence per share at the end of March 2006. The Company has continued to benefit from unrealised gains in its Smaller Companies Portfolio. The High Income Portfolio achieved modest capital growth in the year despite the adverse trend in Sterling interest rates.

The market price of the Company's shares increased from 128.50 pence at the start of 2005 to 158.75 pence at the end of the year and at the end of March 2006 was 184.50 pence. These market prices reflect discounts to net asset value per share[1] of 8.55%, 9.82% and 4.92%.

The chart on page 4 of this Annual Report shows the relative performance of the net asset value per share[2], share price and benchmark since inception up to 28 February 2006. The net asset values per Ordinary Share disclosed on page 4 are as published monthly through the London and Channel Islands Stock Exchanges and are based on investments valued at mid market prices. However, in accordance with new accounting standards, the investments have been valued at fair value (bid price) in these financial statements. Following recent guidance from the Association of Investment Trusts ("AITC"), from the start of 2006 net asset values announced on the London Stock Exchange and The Channel Islands Stock Exchange have been prepared using both bid and mid prices of investments.

In accordance with the Articles of Association of the Company, a Special Resolution will be proposed at this year's Annual General Meeting that the Company ceases to continue as an investment company. If that resolution is passed, the Directors will be required to formulate proposals to be put to Shareholders to reorganise, unitise or reconstruct the Company or to wind up the Company. Notwithstanding that such a Special Resolution requires 75% of those shareholders voting to vote in favour for it to be carried, your Board announced, on 21 February 2006, that it is of the view that, if a simple majority of shareholders voting on the resolution vote in its favour, it will put forward proposals shortly thereafter to Shareholders which would include the opportunity for those shareholders that do not wish to continue with the Company to receive cash at close to net asset value.

A circular convening the Annual General Meeting, which is expected to be held on 26 June 2006, will be sent to Shareholders in due course.

Our Investment Advisers urge caution as to anticipated returns in 2006 from the High Income Portfolio but are more positive about prospective returns on the Smaller Company Portfolio.

D M BRALSFORD
5 April 2006

[1] *Investments valued at bid prices.*
[2] *Investments valued at mid prices.*

Investment Adviser's Report – Smaller Companies Portfolio

The Smaller Companies Portfolio has performed extremely well during the past twelve months. In order to achieve and sustain our income requirements, we have deliberately focussed on companies with good asset backing and strong cash flow. Inevitably, for us to achieve the potential for growth in share prices we have needed to be contrarian. In the past, our decision to invest in the industrial and business services sectors of the economy may have been perceived to be at odds with the approach of many of our competitors. However, there is no doubt that the majority of our companies are delivering impressive results at the moment and that after a long period where business investment was declining or at best static, a strong improvement is underway.

The portfolio consists of many of the most successful international and domestic businesses based in the United Kingdom. There are more fashionable sectors in the Stock Market than those in which the Company invests but it would appear that we are facing economic conditions where market share and global diversification are major strengths for any business seeking to outperform. As a result, we are very confident of our ability to deliver above average results in the future.

During the year under review, a number of our companies have benefited from strong trading conditions and the largest contributors to performance were Rotork, Halstead (James), where special dividends have been a major bonus for shareholders, Pendragon, Renishaw, BSS Group, Robert Walters, Fenner, Laird Group, Primary Health Properties and VP Group. In most cases the improved results were achieved not just through organic growth but acquisitions as well. Wellington Holdings and PD Ports were the subjects of corporate activity and achieved good gains on our investment cost. We maintained our tough stance towards non-performers and sold Business Post and TT Electronics where results did not meet our expectations. Overall portfolio activity was fairly low, reflecting our satisfaction with progress at the majority of our companies.

The proposed merger of Abacus and Deltron was not enough to reverse the decline in the Abacus share price during the period under review. However, we are confident that the deal will prove to be beneficial for shareholders in both companies in due course.

The immediate outlook for the Company appears to be very positive and will be even more so, should sterling weaken as a result of lower domestic economic growth in the months ahead. Corporate activity is also on the increase as business confidence improves and it is quite possible that we shall see further industry consolidation and realise premiums for more of our companies in the year ahead.

P WEBB
UNICORN ASSET MANAGEMENT LIMITED

5 April 2006

Investment Adviser's Report – High Income Portfolio

During the review period Sterling bond markets, especially Gilt-edged securities, fluctuated in thin volume, and a lack of market breadth was a constant theme. However, post speculation over the result of the United Kingdom General Election, fixed income markets began to rally as investors became confident that the rise in inflation above the Government's defined harmonized rate target of 2.00% would be temporary. Indeed the Bank of England went to considerable lengths to reassure market participants and even found the confidence to cut interest rates by a quarter of one percent in early August. This was largely in response to a sharp fall in retail sales and increasing pressure upon manufacturing. It later transpired from the minutes of the meeting that this was against the wishes of the Bank Governor who, for the first time, found himself in the minority when the votes were counted. Meanwhile, the Federal Reserve Board continued with its tightening policy, raising U.S. interest rates on six occasions during 2005. They also made it clear that further increases were in the pipeline, albeit at a reduced pace. The European Central Bank also raised interest rates, as did many other Central Banks, as a precaution against rising inflation, especially higher energy prices. This left the Bank of England somewhat isolated and may lead to some pressure on Sterling.

Sterling bond markets were further agitated by Gordon Brown's decision to rebase his self-imposed golden rule (borrowing must be for investment purposes only) for the second time. In so doing he has risked his reputation for financial prudence. This came hard on the heels of the Treasury's admission that they had considerably overstated the prospects for United Kingdom growth. Financial markets have become increasingly concerned at the ever expanding tendency of the United Kingdom's budget deficit which shows no sign of peaking or abating. Meanwhile the Government's tax take as a percentage of GDP continues to rise sharply.

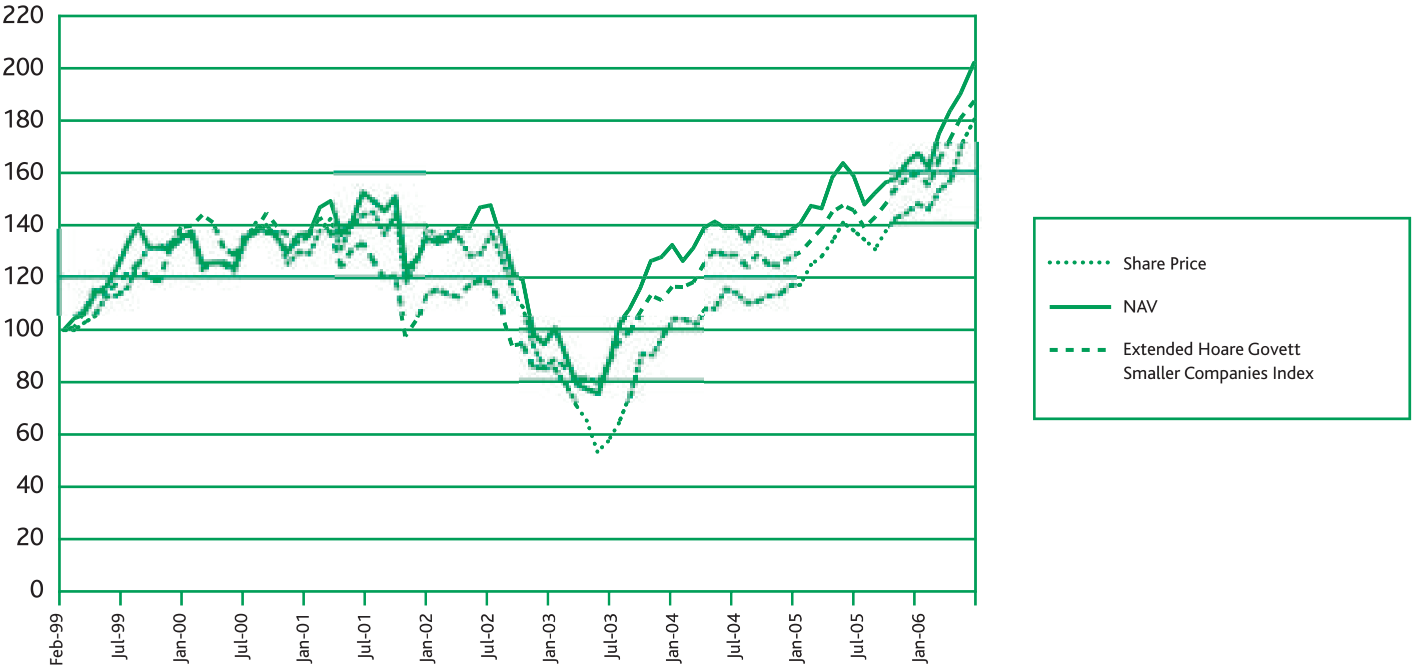
One noticeable feature of the review period has been the surging demand from pension funds trying to match their assets with liabilities which has caused very long dated (30 years plus in duration) yields to fall to historically low levels. However, we view this as a temporary phenomenon and were drawn to statements from Messrs Greenspan, King and Trichet, arguably the world's premier central bankers. All three expressed both surprise and concern at the level of long-term interest rates. In fact, Monsieur Trichet went further, "an underestimation of risk may have pushed asset prices beyond their intrinsic value, especially in fixed income markets".

Looking ahead we view bond markets as slightly vulnerable but likely to remain in a trading range with a downward price bias.

J GOODEY
COLLINS STEWART ASSET MANAGEMENT LIMITED

5 April 2006

Performance Statistics



All data is rebased at 100. Start up date was 11/02/1999. Initial price was 101.5p and NAV 96p.

PERFORMANCE STATISTICS

	Net Asset Value per share[1]	*Price per share*	*Premium/ (discount)*	*Extended HGSC Index (excl. Investment Trusts) – Capital*	*Extended HGSC Index (excl. Investment Trusts) – Total Return*
Launch date (11 February 1999)	96.00p	100.00p	4.00%	1,984.22	3,049.99
30 June 1999	118.39p	114.50p	(3.89%)	2,330.18	3,637.76
31 December 1999	126.74p	138.50p	9.28%	2,762.91	4,359.01
30 June 2000	129.60p	135.50p	4.55%	2,701.71	4,331.09
31 December 2000	131.33p	131.00p	(0.25%)	2,702.18	4,395.94
30 June 2001	143.05p	147.00p	2.76%	2,503.03	4,140.84
31 December 2001	127.85p	137.00p	7.16%	2,283.43	3,836.08
30 June 2002	129.13p	128.00p	(0.88%)	2,113.79	3,603.65
31 December 2002	86.37p	80.00p	(7.38%)	1,693.90	2,942.85
30 June 2003	103.64p	76.00p	(26.67%)	1,981.92	3,508.55
31 December 2003	126.12p	103.75p	(17.74%)	2,346.73	4,209.12
30 June 2004	133.95p	112.25p	(16.20%)	2,560.32	4,449.02
31 December 2004	140.51p	128.50p	(8.55%)	2,752.20	5,079.26
30 June 2005	150.04p	139.75p	(6.86%)	2,939.30	5,503.63
31 December 2005	176.04p	158.75p	(9.82%)	3,423.17	6,490.98
31 March 2006	195.87p	184.50p	(5.80%)	3,768.61	7,204.25
31 December 2004 to 31 December 2005 (% change)	+25.29%	+23.54%	–	+24.38%	–
Launch to 31 December 2005 (% change)	+83.38%	+58.75%	–	+72.52%	–

TOTAL RETURN

31 December 2004 to 31 December 2005 (% change)	+31.69%	+30.54%	–	–	+27.79%
Launch to 31 December 2005 (% change)	+157.33%	+129.75%	–	–	+112.82%

[1]*Investments valued at mid prices.*

Risk Warning

An investment in the Company is only suitable for financially sophisticated investors who are capable of evaluating the risks and merits of such investment, or other investors who have been professionally advised with regard to investment, and who have sufficient resources to bear any loss which might result from such investment. There can be no guarantee that investors will recover their initial investment. This investment employs gearing and may be subject to sudden and large falls in value. You should be aware that movements in the net asset value of the Company, and therefore the price of the shares, may be more volatile than movements in the price of the underlying investments and that there is a risk that you may lose all the money that you have invested. Investors considering an investment should consult their stockbroker, bank manager, solicitor, accountant or other independent financial adviser.

Investors contemplating an investment in Ordinary Shares should recognise that the market value of, and the income derived from, such shares can fluctuate and may not always reflect the underlying value of the Company's portfolio. Securities listed on recognised exchanges are valued at their bid market prices as at the close of business on 31 December 2005. The market prices at which these investments are valued may not be the realisable value of those investments, taking into account both the size of the Group's holding, the frequency with which such investments are traded and the spread between the bid and offer prices.

Future dividends on the Ordinary Shares will depend on the dividend and capital growth of investments in the underlying portfolio. Dividend cuts by companies within the portfolio or falls in the share prices of the underlying investments may result in the Ordinary Shares yielding less in future years. Falling bond prices or reductions in bond yields may also lead to a reduction in dividends on the Ordinary Shares. Any change in the tax treatment of dividends or interest paid or received by the Company may reduce the level of dividend received by Ordinary Shareholders.

A fall in the underlying asset value could result in the Company breaching the financial covenants contained in the loan facility, whereby the Company may be required to repay such borrowings forthwith in whole or in part together with any attendant costs. In such circumstances the Company's ability to maintain dividend levels, and the net asset value attributable to the Ordinary Shares, could be adversely affected.

Current and prospective investors should be aware that, whilst the use of borrowings should enhance the net asset value of the Ordinary Shares where the value of the Company's underlying assets is rising, it will have the opposite effect where the underlying asset value is falling.

There can be no guarantee that the Company's investment objectives will be met.

Principal Investments

Investments – High Income

as at 31 December 2005

Stock	Sector	Market Value[1] £'000
Conversion 9% Loan Stock 2011	UK Gilt	4,328
Nationwide FRN June 2010	Building Society	2,501
Centrica 5.875% EMTN November 2012	Gas, energy and telecoms	1,052
Barclays Bank 9.875% Und Sub Nts (Var)(Br)	Banking	778
Transco 6% June 2017	Energy	715
Blue Chip Value & Income Fund Ord GBP 0.125	Investment Company	706
Royal Bank of Scotland 8.375% Sub Nts January 2007	Banking	519
Empyrean Finance FRN March 2013	Consultants	500
European Value & Income Fund Ord GBP 0.10	Investment Company	255
		11,354

The investments in high income securities represent 15.75% of the investment portfolio (2004: 14.59%).

The total value of investments held at the year end that are advised or managed by Collins Stewart Fund Management Limited is £961,066; 1.33% (2004: £744,550; 1.21%).

10 Principal Investments – Smaller Companies

as at 31 December 2005

Stock	Sector	Market Value[1] £'000
James Halstead Ord GBP 0.10	Miscellaneous Manufacturing	5,792
Rotork Ord GBP 0.05	Engineering	5,368
Pendragon Ord GBP 0.25	Motor Distributors	4,160
Robert Walters Ord GBP 0.20	Recruitment Services	3,843
Renishaw Ord GBP 0.20	Electronics	3,822
Diploma Ord GBP 0.05	Distributions & Wholesale	3,760
Laird Group Ord GBP0.25	Electronics	3,653
Fenner Ord GBP0.25	Miscellaneous Manufacturing	3,282
BSS Group Ord GBP 0.20	Retail & Building Products	3,232
Vp Ord GBP 0.05	Construction and Building Material	3,143
		40,055

The 10 principal investments in smaller companies represent 55.57% of the investment portfolio (2004: 53.36%).

[1]*Valued at mid prices.*

Principal Investments

Investments – High Income

as at 31 December 2004

Stock	*Sector*	*Market Value[1]* *£'000*
Conversion 9% Loan Stock	UK Gilt	4,381
Grand Metro Finance 9% Bonds May 2005	Beverages	1,016
Conversion 9.5% Loan Stock 2005	UK Gilt	1,015
Barclays Bank 9.875% Und Sub Nts (Var)(Br)	Banking	801
Royal Bank of Scotland 8.375% Sub Nts January 2007	Banking	533
Blue Chip Value & Income Fund Ord GBP 0.125	Investment Company	530
BAA 7.875% Bonds February 2007 GBP (Var)	Aviation Services	317
European Value & Income Fund Ord GBP 0.10	Investment Company	215
Lloyds TSB Group 8.50% Sub Bonds March 2006	Banking	182
		8,990

10 Principal Investments – Smaller Companies

as at 31 December 2004

Stock	*Sector*	*Market Value[1]* *£'000*
James Halstead Ord GBP 0.10	Miscellaneous Manufacturing	5,096
BSS Group Ord GBP 0.20	Retail & Building Products	4,629
Wellington Holdings Ord GBP 0.10	Miscellaneous Manufacturing	3,359
Rotork Ord GBP 0.05	Engineering	3,303
Diploma Ord GBP 0.05	Distributions & Wholesale	3,146
Pendragon Ord GBP 0.25	Motor Distributors	3,000
Robert Walters Ord GBP 0.20	Recruitment Services	2,756
Alpha Airports Group Ord GBP 0.10	Food – Catering	2,714
Renishaw Ord GBP 0.20	Electronics	2,502
Vp Ord GBP 0.05	Construction and Building Materials	2,373
		32,878

[1]*Valued at mid prices.*

Report of the Directors

The Directors present their report and the audited financial statements for the year ended 31 December 2005.

Status and activities

The Company is a closed-end investment company registered under the provisions of the Companies (Guernsey) Law, 1994.

The Ordinary Shares of the Company are listed on the Official List of the United Kingdom Listing Authority and are traded on the London Stock Exchange. The shares are also listed on the Official List of The Channel Islands Stock Exchange by way of a secondary listing.

The Company's objectives are to provide Shareholders with a high income and also the opportunity for income and capital growth by investing primarily in smaller capitalised United Kingdom companies admitted to the Official List of the United Kingdom Listing Authority and traded on the London Stock Exchange, or traded on AIM.

Results and dividends

The results attributable to Shareholders for the year and the transfer to reserves are shown on page 13. The Company made a revenue return for the year of 9.07p (2004: 7.53p) and a capital gain of 35.19p (2004: gain of 16.61p) per Ordinary Share.

The Company paid dividends during the year as follows:–

	Pay date	*Dividend per share*
First interim	24 March 2005	2.00p
Second interim	30 June 2005	2.00p
Third interim	29 September 2005	2.00p
Fourth interim	23 December 2005	2.00p
Special	23 December 2005	1.00p
		9.00p

The Directors do not propose a final dividend for the year.

Net Asset Value Per Ordinary Share

At the year end the net assets of the Company (with investments valued at bid prices) were £51,427,357 (2004: £40,990,327) and the net asset value per Ordinary Share was 173.74p (2004: 138.48p).

Fixed asset investments

The market value of the Company's investments (valued at bid prices) as at 31 December 2005 was £72,075,287 (2004: £61,616,460), showing a surplus of £25,816,830 (2004: surplus of £17,586,421) against book cost. At the year end 84.25% (2004: 86.11%) of the portfolio (excluding cash) related to the smaller companies portfolio which, in respect of capital return, has outperformed the high income portfolio since the Company's inception. At 31 December 2005 there was an unrealised surplus of £26,783,564 (2004: surplus of £18,781,480) on the smaller companies portfolio (excluding cash) and an unrealised deficit of £966,734 (2004: deficit £1,195,159) on the high income portfolio.

Taxation

The Company has been granted exemption from Guernsey taxation under the terms of the Income Tax (Exempt Bodies) (Guernsey) Ordinance 1989 so that the Company is exempt from Guernsey taxation on income arising outside Guernsey and bank interest receivable in Guernsey. The Company is therefore only liable to a fixed fee of £600 per annum.

Authority to buy back shares

No shares were purchased for cancellation during the period. The Company intends to seek to renew the necessary authority to buy back Ordinary Shares at the forthcoming Annual General Meeting.

Management

The Manager, Collins Stewart Fund Management Limited, manages the Company's affairs and provides administration, registration and secretarial services to the Company, in accordance with the policies laid down by the Directors. Under the Investment Advisory Agreements, the Manager has appointed Unicorn Asset Management Limited and Collins Stewart Portfolio Management Limited as Investment Advisers to the Company. Under the Investment Advisory Agreements, the Manager ensures that Unicorn Asset Management Limited and Collins Stewart Portfolio Management Limited act in accordance with the policies laid down by the Directors and in accordance with the investment restrictions referred to in those Agreements and the Articles of Association. Under the Management Agreement, the Manager receives an aggregate annual fee from the Company payable quarterly in arrears, at the rate of 1% of the total assets of the Company. In addition, the Manager is eligible for a performance fee payable at the end of each year, provided that the total assets per share attributable to the Ordinary Shares grow at a compound rate in excess of 10% per annum (the benchmark) and a minimum total dividend of 8.5p is paid. The benchmark is subject to a "high-water mark" whereby if at the end of any preceding financial period, a higher net asset value per share has been achieved, then that higher figure becomes the benchmark. If the conditions are met a fee of 15% of any excess of the net asset value per share over the benchmark, weighted for the average number of shares in issue, is payable to the Manager. The Manager is responsible for paying the fees of the Investment Advisers. As at 31 December 2005 the benchmark net asset value per share was 185.66p (2004: 168.78p). No performance fee has been paid in respect of the year ended 31 December 2005 (2004: nil).

Report of the Directors

Collins Stewart (CI) Limited acts as the Company's custodian, and, as set out in the Custodian Agreement, receives a fee from the Company at the annual rate of 0.05% of the total assets calculated on the last dealing day in each calendar month and payable in arrears, together with a £40 per bargain settlement charge.

Appointment of the Manager

The Directors believe that Collins Stewart Fund Management Limited has performed creditably during the year ended 31 December 2005.

In the opinion of the Directors it is in the interests of shareholders as a whole to retain the services of Collins Stewart Fund Management Limited.

Directors

The present members of the Board are listed on the inside back cover. At 31 December 2005 the Directors' interests in the share capital of the Company were as follows:

	Ordinary 25p shares
David Martin Bralsford	150,000
Shane Raymond Le Prevost	25,000
John Michael McKean	20,000
John Campbell Boothman	–

There were no changes in the interests of the Directors between 31 December 2005 and 31 March 2006.

There are no service contracts in place between the Company and the Directors.

Future Prospects

The Directors are reasonably confident that the good performance of the Company can be maintained over the coming year. Further details are given in the Chairman's Statement and the Investment Advisers' Reports on pages 1-3.

Substantial Shareholdings

On 28 February 2006 the following interests in 3% or more of the issued Ordinary Share Capital had been notified to the Company.

	Number of shares	*Percentage of share capital*
Funds managed by		
Brookdale Group	7,752,443	26.19
UBS Laing & Cruickshank	1,920,908	6.49
Collins Stewart	1,774,400	5.99
Premier Asset Management	1,773,694	5.99
Imia Investment Group	1,710,000	5.78
Aegon Asset Management	1,025,000	3.46
Britannic Asset Management	900,000	3.04

Going Concern

After making reasonable enquiries, 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.

The Company has entered into a loan agreement with Bank of Scotland International, the terms of which contain a number of financial covenants. The Company has complied with these financial covenants throughout the financial year. The Directors have no reason to suppose that any breaches of these financial covenants will be made in the foreseeable future and as a result do not consider there to be any threat to the going concern status of the Company. The Company has extended the repayment date of the loan from 11 February 2006 to 31 October 2006.

As set out in the Prospectus dated 5 February 1999, the Company does not have a fixed life but the Board considers it desirable that Shareholders should have the opportunity to review the future of the Company at appropriate intervals. Accordingly, at the Annual General Meeting of the Company which is expected to be held on 26 June 2006 a Special Resolution will be proposed that the Company ceases to continue as presently constituted. A circular convening the Annual General Meeting will be sent to Shareholders in due course. In line with the revised Statement of Recommended Practice ("SORP"), for Financial Statements of Investment Trust Companies, issued in December 2005, this continuation vote does not affect the presentation of these financial statements in accordance with the going concern concept.

Litigation

The Company is not engaged in any litigation or claim of material importance, nor, so far as the Directors are aware, is any litigation or claim of material importance pending or threatened against the Company.

Auditors

KPMG Channel Islands Limited have expressed their willingness to continue to act as Auditors to the Company and a resolution for their reappointment will be proposed at the forthcoming Annual General Meeting.

Corporate Governance

As the Company is not incorporated within the United Kingdom it is not, strictly speaking, required to comply with the new Combined Code published by the Financial Reporting Council (the "2003 FRC Code"). However, the Directors place a high degree of importance on ensuring that high standards of Corporate Governance are maintained. As a result, many of

Report of the Directors

the principles set out in the 2003 FRC Code have been adopted and these are summarised below, together with the areas of non-compliance.

Audit Committee

The audit committee comprises the full Board of the Company, with the exception of Mr Le Prevost, and meets at least twice a year. It provides a forum through which the Company's auditors report to the Board.

Board Responsibilities

The Board currently comprises four members, of which three are independent non-executive directors. The Company has no executive directors. As all the Directors are non-executive, the Chairman (Mr Bralsford) is the senior non-executive director. This is not in accordance with provision A.2.1 of the 2003 FRC Code but is felt to be appropriate for the size and nature of the Company.

The Board has engaged external companies to undertake the investment management, administrative and custodial activities of the Company. Clear documented contractual arrangements are in place with these firms which define the areas where the Board has delegated responsibility to them. The Company holds at least four Board meetings per year, at which the Directors review the Company's investments and all other important issues to ensure control is maintained over the Company's affairs.

Since all the Directors are non-executive, the Company is not required to state how it applied B.1 to B.3 of the 2003 FRC Code on directors' remuneration. However, the fee that was paid to each Director during the period is shown in note 8 to the financial statements.

All members of the Board are expected to attend each Board meeting and to arrange their schedules accordingly, although non-attendance is unavoidable in certain circumstances. Mr Bralsford and Mr McKean attended all six meetings in the year while Mr Le Prevost missed one meeting and Mr Boothman missed two meetings.

Dialogue With Shareholders

The Directors are always available to enter into dialogue with shareholders. All Ordinary Shareholders will have the opportunity, and indeed are encouraged, to attend and vote at the Annual General Meeting during which the Board and the Investment Managers will be available to discuss issues affecting the Company.

Internal Control and Financial Reporting

The Board is responsible for establishing and maintaining the Company's system of internal control. Internal control systems are designed to meet the particular needs of the Company and the risks to which it is exposed, and, by their very nature, provide reasonable, but not absolute, assurance against material misstatement or loss. The key procedures which have been established to provide effective internal controls are as follows:

- Collins Stewart Fund Management Limited is responsible for the provision of administration and company secretarial duties.
- The duties of investment management, accounting and the custody of assets are segregated. The procedures are designed to complement one another.
- Custody of assets is undertaken by Collins Stewart (CI) Limited.
- The non-executive Directors of the Company clearly define the duties and responsibilities of their agents and advisers in the terms of their contracts.
- The Board reviews financial information produced by the Manager on a regular basis.
- The Company does not have an internal audit department. All of the Company's management functions are delegated to independent third parties and it is therefore felt that there is no need for the Company to have an internal audit facility.

The Directors do not conduct a formal annual review of the internal controls. However, the Board considers that the procedures employed by the service providers adequately mitigate the risks to which the Company is exposed.

Payment to Creditors

Amounts due to suppliers and service providers are settled promptly within the terms of the payment, except in cases of dispute. The Company does not have any trade creditors.

Financial Risk Profile

The Company's financial instruments comprise investments, cash, loans and various items such as debtors and creditors that arise directly from the Company's operations. The main purpose of these instruments is the investment of Shareholders' funds.

The main risks are market price, liquidity, interest rate, and credit risks. Further details are given in note 23 to the financial statements and a more detailed risk warning is given on page 5.

Report of the Directors

Directors' responsibilities

The Directors are responsible for preparing financial statements for each financial period which give a true and fair view of the state of affairs of the Company for that period and are in accordance with applicable laws.
In preparing those financial statements 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 financial statements; and
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are also responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with The Companies (Guernsey) Law, 1994. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed on behalf of the Board of Directors

D M BRALSFORD	J M McKEAN
Director	Director
5 April 2006	5 April 2006

Independent Auditors' Report to the Members of the Acorn Income Fund Limited

We have audited the financial statements of Acorn Income Fund Limited for the year ended 31 December 2005 which comprise the Income Statement, Statement of Total Recognised Gains and Losses, Reconciliation of Movements in Shareholders' Funds, Balance Sheet, Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out herein.

This report is made solely to the Company's members, as a body, in accordance with section 64 of The Companies (Guernsey) Law, 1994. 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 Report of the Directors and the financial statements in accordance with applicable Guernsey law and United Kingdom accounting standards as set out in the the Report of the Directors on page 11.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with The Companies (Guernsey) Law, 1994. We also report to you if, in our opinion, the Company has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We read the Report of the Directors and consider the implications for our report if we become aware of any apparent misstatements within it.

We read the other information accompanying the financial statements and consider whether it is consistent with those statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, 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 financial statements 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 financial statements.

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with UK Accounting Standards, of the state of the Company's affairs as at 31 December 2005 and of its result for the year then ended; and
- have been properly prepared in accordance with The Companies (Guernsey) Law, 1994.

KPMG Channel Islands Limited
Chartered Accountants
Guernsey

5 April 2006

Income Statement

for the year ended 31 December 2005

	Notes	Revenue 2005 £'000	Capital 2005 £'000	Total 2005 £'000	Revenue 2004 £'000	Capital (restated) 2004 £'000	Total (restated) 2004 £'000
Gains on investments	4	–	12,177	12,177	–	6,784	6,784
Income	5	3,391	–	3,391	2,945	–	2,945
Management fee	6	(176)	(529)	(705)	(162)	(487)	(649)
Other expenses	7	(158)	(111)	(269)	(161)	(199)	(360)
Net return on ordinary activities before finance costs		3,057	11,537	14,594	2,622	6,098	8,720
Interest payable and similar charges	9	(373)	(1,120)	(1,493)	(394)	(1,181)	(1,575)
Net return for the year		2,684	10,417	13,101	2,228	4,917	7,145
Total return per Ordinary Share	11	9.07p	35.19p	44.26p	7.53p	16.61p	24.14p
Dividend per Ordinary Share (distributed)	10	9.00p	–	9.00p	9.00p	–	9.00p

The total columns of this statement represent the Income Statement of the Company.

Statement of Total Recognised Gains and Losses

for the year ended 31 December 2005

	Note	Revenue 2005 £'000	Capital 2005 £'000	Total 2005 £'000	Revenue 2004 £'000	Capital (restated) 2004 £'000	Total (restated) 2004 £'000
Net return for the year		2,684	10,417	13,101	2,228	4,917	7,145
Prior year adjustment	3	–	(601)	(601)			
Total recognised gains and losses recognised since last annual report		2,684	9,816	12,500			

The revenue and capital columns represent supplementary information.

All revenue and capital items in the above statements derive from continuing operations.

The accompanying notes on pages 17 to 26 form an integral part of the financial statements.

Reconciliation of Movements in Shareholders' Funds

for the year ended 31 December 2005

	Notes	Share capital £'000	Share premium £'000	Revenue reserve £'000	Special reserve £'000	Capital reserve £'000	Total £'000
Balance at 1 January 2005 as previously stated		7,400	17,079	882	10,000	6,230	41,591
Prior year adjustment	3	–	–	–	–	(601)	(601)
Balance as at 1 January 2005 as restated		7,400	17,079	882	10,000	5,629	40,990
Return for the year		–	–	2,684	–	10,417	13,101
Dividends paid	10	–	–	(2,664)	–	–	(2,664)
Balance as at 31 December 2005		7,400	17,079	902	10,000	16,046	51,427

Reconciliation of Movements in Shareholders' Funds

for the year ended 31 December 2004

	Notes	Share capital £'000	Share premium £'000	Revenue reserve £'000	Special reserve £'000	Capital reserve £'000	Total £'000
Balance at 1 January 2004 as previously stated		7,400	17,079	1,318	10,000	1,534	37,331
Prior year adjustment	3	–	–	–	–	(822)	(822)
Balance as at 1 January 2004 as restated		7,400	17,079	1,318	10,000	712	36,509
Return for the year as restated		–	–	2,228	–	4,917	7,145
Dividends paid	10	–	–	(2,664)	–	–	(2,664)
Balance as at 31 December 2004 as restated		7,400	17,079	882	10,000	5,629	40,990

The accompanying notes on pages 17 to 26 form an integral part of the financial statements.

Balance Sheet

as at 31 December 2005

	Notes	2005 £'000	2004 (restated) £'000
Fixed assets			
Listed investments	12	72,075	61,616
Current assets			
Debtors	13	651	1,271
Cash at bank		5,238	4,242
		5,889	5,513
Creditors – amounts falling due within one year			
Other creditors	14	(921)	(523)
Bank loan	15	(25,616)	–
		(26,537)	(523)
Net current (liabilities)/assets		(20,648)	4,990
Total assets less current liabilities		51,427	66,606
Creditors – amounts falling due after more than one year			
Long-term bank loan	15	-	(25,616)
Net asset value		51,427	40,990
Share capital and reserves			
Called-up share capital	16	7,400	7,400
Share premium	17	17,079	17,079
Revenue reserve		902	882
Special reserve	17	10,000	10,000
Capital reserve	17	16,046	5,629
Total shareholders' funds attributable to equity interests		51,427	40,990
Net asset value per Ordinary Share	18	173.74p	138.48p

These financial statements on pages 13 to 26 were approved by the Board of Directors on 3 April 2006.

Signed on behalf of the Board

D M BRALSFORD
Director

5 April 2006

J M McKEAN
Director

5 April 2006

The accompanying notes on pages 17 to 26 form an integral part of the financial statements.

Cash Flow Statement

for the year ended 31 December 2005

	Notes	2005 £'000	2004 (restated) £'000
Net cash inflow from operating activities	19	2,533	1,932
Servicing of finance			
Interest paid		(1,607)	(1,431)
Net cash outflow from servicing of finance		(1,607)	(1,431)
Investing activities			
Purchase of investments		(16,377)	(17,318)
Sale of investments		19,111	20,127
Net cash inflow from investing activities		2,734	2,809
Equity dividends paid		(2,664)	(2,664)
Cash inflow before financing		996	646
Net cash flow from financing		–	–
Increase in cash in the year	20	996	646
Opening cash balance		4,242	3,596
Increase in cash in the year		996	646
Closing cash balance		5,238	4,242

The accompanying notes on pages 17 to 26 form an integral part of the financial statements.

Notes to the Financial Statements

for the year ended 31 December 2005

1. Accounting policies

The accounting policies, all of which have been applied consistently throughout the year, in the preparation of the Company's financial statements, are set out below:

a) Accounting convention

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of investments, and in accordance with applicable United Kingdom accounting standards and with the revised Statement of Recommended Practice ("SORP"), for Financial Statements of Investment Trust Companies , issued in December 2005.

b) Income

Dividends receivable on equity shares are taken into account on the ex-dividend date. Income on debt and fixed interest securities is recognised on an accruals basis. Dividends received from United Kingdom registered companies are accounted for net of imputed tax credits.

Bank interest is accounted for on an accruals basis.

c) Expenses

All expenses are accounted for on an accruals basis. Expenses are charged through the revenue reserve except as follows:

(i) expenses which are incidental to the acquisition or disposal of an investment are charged through the capital reserve;

(ii) 75% of the Company's management fee and financing costs are charged to the capital reserve in line with the Board's expected long-term split of returns between income and capital gains from the investment portfolio; and

(iii) 100% of any performance fee is charged to the capital reserve.

d) Capital reserve

The following are accounted for in the capital reserve:

(i) realised gains and losses on the realisation of investments;

(ii) unrealised gains and losses on investments; and

(iii) expenses charged to the capital reserve in accordance with the above accounting policies.

e) Transaction costs

Previously, transaction costs incurred on the acquisition of an investment were included within the cost of that investment and transaction costs incurred on the disposal of an investment were deducted from the proceeds on sale. However, in accordance with Financial Reporting Standard 26 *"Financial Instruments: Measurement"* ("FRS 26"), transaction costs are now charged through the Income Statement to the capital reserve in the period in which they are incurred.

f) Investments

Classification

In accordance with FRS 26, all investments are now classified as "fair value through profit or loss". The Smaller Companies Portfolio and the High Income Portfolio are managed and their performance evaluated on a fair value basis, in accordance with a documented investment strategy. Information about each portfolio is provided internally to the Company's Board of Directors. Accordingly, upon initial recognition, the investments are designated by the Company as at "fair value through profit or loss".

Recognition

The Company recognises financial assets held as fair value through profit or loss assets on the date it commits to purchase the instruments. From this date, any gains and losses arising from the changes in fair value of the assets are recognised in the capital reserve.

Measurement

Fair value through profit or loss assets are initially recognised at cost, being the fair value of the consideration given, excluding transaction costs associated with the investment (see note 1e). Subsequent to initial recognition, all fair value through profit or loss assets are measured at fair value with changes in value being recognised in the Income Statement and taken to the capital reserve. For investments actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices as at the close of business on the Balance Sheet date. This differs from prior periods where investments were measured at quoted market mid prices. The impact of this is disclosed in note 3.

Notes to the Financial Statements

for the year ended 31 December 2005

1. Accounting policies (continued)

f) Investments (continued)

Derecognition

A fair value through profit or loss asset is derecognised when the Company loses control over the contractual rights that comprise that asset. This occurs when rights are realised, expire or are surrendered. Realised gains and losses on fair value through profit or loss assets sold are calculated as the difference between the sales proceeds (excluding transaction costs (see note 1e)) and costs. Fair value through profit or loss assets that are sold are derecognised and corresponding receivables from the buyer for the payment are recognised as of the date the Company commits to sell the assets. The Company uses the weighted average method to determine realised gains and losses on derecognition.

g) Impact of revisions to United Kingdom accounting standards

In compliance with Financial Reporting Standard 25 *"Financial Instruments: Disclosure and Presentation"* ("FRS 25") and FRS 26, the Company has designated and reclassified all investments to "fair value through profit or loss". Fair value through profit or loss assets are now measured at Stock Exchange quoted market bid prices whereas they were previously valued at quoted market mid prices.

In addition, the transaction costs incurred on the purchase and sale of investments are now charged through the Income Statement in the period in which they are incurred instead of being included within the cost of the investment or deducted from the proceeds of a sale. The impact of this is disclosed in note 3.

2. Taxation

The Company has been granted exemption from Guernsey taxation under the Income Tax (Exempt Bodies) (Guernsey) Ordinance 1989 and is charged an annual exemption fee of £600 (2004: £600).

3. Change of accounting policy

As explained in note 1g, charges incurred on the purchase and sale of fair value through profit or loss investments are now charged through the Income Statement in the period in which they are incurred instead of being included within the cost of the investment or deducted from the proceeds of a sale. This had no impact on the net asset value of the Company or reserves but impacted the unrealised and realised gain or loss on investments as below. However, the effect of valuing investments at quoted market bid prices not only impacts upon the unrealised gain or loss on investments, but also on the net asset value (see note 18). The valuation of investments at bid price instead of mid price has reduced the net asset value at 31 December 2005 by £681,000 (2004: £601,000).

	Realised gains on fair value through profit or loss investments £'000	*Movements in unrealised gains/(losses) on fair value through profit or loss investments £'000*	*Other expenses £'000*
Gain for the year ended 31 December 2005 under the previous accounting policy	3,821	8,325	(158)
Transaction charges	126	(15)	(111)
Valuation of investments at bid prices	–	(80)	–
Gain/(expense) for the year ended 31 December 2005 under the current accounting policy	3,947	8,230	(269)

Notes to the Financial Statements

for the year ended 31 December 2005

3. Change of accounting policy (continued)

	Realised losses on fair value through profit or loss investments £'000	Movements in unrealised gains/(losses) on fair value through profit or loss investments £'000	Other expenses £'000
(Loss)/gain for the year ended 31 December 2004 (as previously stated)	(5,699)	12,063	(161)
Transaction charges	267	(68)	(199)
Valuation of investments at bid prices	–	219	–
(Loss)/gain/(expense) for the year ended 31 December 2004 (as restated)	(5,430)	12,214	(360)

The transaction costs associated with the purchase and sale of investments have been shown separately in the note to the Cash Flow Statement. Consequently, the purchase of fair value through profit or loss investments decreased by £83,182 (2004: £137,624), the proceeds on sale of fair value through profit or loss investments increased by £26,592 (2004: £61,017) and the net cash inflow from operating activities decreased by £109,774 (2004: £198,641).

4. Gains/(losses) on investments

	2005 £'000	2004 (restated) £'000
Realised gain/(loss) on sales	3,947	(5,430)
Movement in unrealised appreciation/depreciation	8,230	12,214
	12,177	6,784

5. Income

	2005 £'000	2004 £'000
Dividend income	2,512	2,093
Bond interest	634	666
Bank interest	245	186
	3,391	2,945

6. Management fee

The Manager of the Company is entitled under the Management Agreement with the Company to receive a management fee from the Company at the annual rate of 1.0% of the total assets of the Company, payable quarterly in arrears. Where any investments comprised in the assets of the Company are in funds managed by or advised by the Manager or Investment Adviser or an affiliate of either of them, the value of such investments is deducted from total assets for the purposes of calculating the management fee.

In addition, the Manager is entitled to receive a performance fee, payable at the end of each financial period of the Company, at the rate of 15% of any excess of the net asset value per share (with investments valued at mid prices) over the benchmark net asset value per share as at the last calculation day in the relevant financial period, multiplied by the time weighted number of shares in issue within such period. The benchmark net asset value per share is the higher of 104.8p, compounded at 10% per annum since 31 December 1999, and the highest net asset value per share as of the last calculation day in any preceding financial period. When calculating the performance fee, the net asset value per share is reduced by the amount that the dividend per share paid during that year is less than 8.5p. As at 31 December 2005 the benchmark net asset value per share was 185.66p (2004: 168.78p). No performance fee has been paid in respect of the year ended 31 December 2005 (2004: nil).

Notes to the Financial Statements

for the year ended 31 December 2005

6. Management fee (continued)

The Manager has delegated the obligations for the performance of the investment management services to Unicorn Asset Management Limited ("the Smaller Companies Investment Adviser") and Collins Stewart Portfolio Management Limited ("the High Income Investment Adviser"). The agreements are between the Investment Advisers and the Manager, not the Company. All Investment Advisory fees are paid out of the management fees and performance fees received by the Manager from the Company.

Both Investment Advisers are entitled to receive an annual fee at the rate of 0.5% of the total assets attributable to the investments in relation to which the Investment Adviser acts. The Smaller Companies Investment Adviser is entitled to 5/8ths of the Manager's performance fee, while the Manager may, at its discretion, pay the High Income Investment Adviser a proportion of the remaining performance fee. In addition, the Smaller Companies Investment Adviser is entitled to receive, from the Manager, a fixed annual fee of £7,500 in relation to marketing services provided to investors.

The Investment Advisory Agreements may be terminated by the Manager or the Investment Advisers, giving not less than 12 months' notice in writing, or otherwise in circumstances where one of the parties has a receiver appointed over its assets or if an order is made or an effective resolution passed for the winding up of one of the parties. On termination the Investment Adviser shall be entitled to receive all fees accrued up to the date of the termination (or thereafter if the Investment Adviser necessarily incurs expenses arising out of the termination of the agreement) but shall not be entitled to compensation, except in the case of a wrongful termination by the Manager.

7. Other expenses

	Revenue 2005 £'000	*Capital 2005 £'000*	*Total 2005 £'000*	*Revenue 2004 £'000*	*Capital (restated) 2004 £'000*	*Total (restated) 2004 £'000*
Custody and settlement fees	39	–	39	38	–	38
Auditors' remuneration	9	–	9	9	–	9
Directors' remuneration (note 8)	40	–	40	40	–	40
Transaction charges	–	111	111	–	199	199
Other expenses	70	–	70	74	–	74
	158	111	269	161	199	360

8. Directors' remuneration

	2005 £'000	*2004 £'000*
David Martin Bralsford	16	16
John Michael McKean	12	12
John Boothman	12	12
Shane Le Prevost	–	–
	40	40

No bonus or pension contributions were paid or payable on behalf of the Directors. Details of the Directors' interests in the share capital are set out in the Report of the Directors on page 9.

Shane Le Prevost waived his rights to his Director's fee for the year (2004: nil).

9. Interest payable and similar charges

The interest payable relates to interest due on the bank loan, details of which are disclosed in note 15.

Notes to the Financial Statements

for the year ended 31 December 2005

10. Dividends in respect of equity shares

	2005 £'000	2005 pence	2004 £'000	2004 pence
Dividends on Ordinary Shares:				
First interim paid	592	2.00	592	2.00
Second interim paid	592	2.00	592	2.00
Third interim paid	592	2.00	592	2.00
Special dividend paid	296	1.00	296	1.00
Fourth interim paid	592	2.00	592	2.00
	2,664	9.00	2,664	9.00

11. Return per Ordinary Share

The revenue return per Ordinary Share is based on net revenue of £2,684,205 (2004: £2,227,687) and on a weighted average number of 29,600,002 (2004: 29,600,002) Ordinary Shares in issue throughout the year. The capital gain per Ordinary Share is based on the net capital gain of £10,416,826 (2004: gain of £4,917,396) and on a weighted average number of 29,600,002 (2004: 29,600,002) Ordinary Shares in issue throughout the year.

12. Listed investments

	Smaller Companies Portfolio 2005 £'000	High Income Portfolio 2005 £'000	Total 2005 £'000	Smaller Companies Portfolio (restated) 2004 £'000	High Income Portfolio (restated) 2004 £'000	Total (restated) 2004 £'000
Opening valuation	52,626	8,990	61,616	49,228	8,747	57,975
Purchases at cost	8,519	8,666	17,185	12,149	5,170	17,319
Sales – proceeds	(12,462)	(6,441)	(18,903)	(15,247)	(5,215)	(20,462)
– realised gains/(losses)	4,036	(89)	3,947	23	(5,453)	(5,430)
Movement in unrealised appreciation/depreciation	8,002	228	8,230	6,473	5,741	12,214
Closing valuation	60,721	11,354	72,075	52,626	8,990	61,616
Closing book cost	33,938	12,321	46,259	33,845	10,185	44,030
Closing unrealised appreciation/ (depreciation)	26,783	(967)	25,816	18,781	(1,195)	17,586
Closing valuation	60,721	11,354	72,075	52,626	8,990	61,616

Previously recognised as unrealised appreciation/depreciation

	Smaller Companies Portfolio 2005 £'000	High Income Portfolio 2005 £'000	Total 2005 £'000	Smaller Companies Portfolio (restated) 2004 £'000	High Income Portfolio (restated) 2004 £'000	Total (restated) 2004 £'000
Realised gains/(losses) attributable to current year	662	4	666	(211)	240	29
Amounts previously recognised as unrealised appreciation/ (depreciation) on these sales	3,374	(93)	3,281	234	(5,693)	(5,459)
Gains/(losses) realised on investments sold	4,036	(89)	3,947	23	(5,453)	(5,430)

Notes to the Financial Statements

for the year ended 31 December 2005

13. Debtors

	2005 £'000	*2004 £'000*
Accrued income	563	665
Amounts due from brokers	71	588
Other debtors	17	18
	651	1,271

14. Other creditors

	2005 £'000	*2004 £'000*
Investments outstanding for settlement	499	–
Management fee	185	167
Bank interest	199	313
Other creditors	38	43
	921	523

15. Bank loan

	2005 £'000	*2004 £'000*
Bank of Scotland International facility	25,616	25,616

Under loan agreements dated 28 September 1999 and 21 December 2000 between the Company and Bank of Scotland International, a term loan of £25,616,000 has been made available. The Company has extended the repayment date of the loan from 11 February 2006 to 31 October 2006 – the terms of the loan remain unchanged. In prior periods the bank loan had been accounted for as a creditor falling due after more than one year, however, as the repayment date is now 31 October 2006, the bank loan has been included in amounts falling due within one year.

The interest rates payable on the loan are based on LIBOR plus a margin of 1% plus Mandatory Liquid Asset ("MLA") costs and are fixed as follows:

	2005 £'000	*2004 £'000*
Fixed until 31/01/06 at 5.73188% (2004: 28/02/05 at 6.195%)	5,000	5,000
Fixed until 31/01/06 at 5.7375% (2004: 27/04/05 at 5.963%)	5,000	5,000
Fixed until 31/01/06 at 5.7375% (2004: 27/04/05 at 5.963%)	5,000	5,000
Fixed until 31/01/06 at 5.74503% (2004: 30/09/05 at 5.445%)	5,616	5,616
Fixed until 31/01/06 at 5.71423% (2004: 09/12/05 at 5.885%)	5,000	5,000
	25,616	25,616

The average cost of borrowings at the year end was 5.73% (2004: 5.88%).

16. Share capital

	2005 £'000	*2004 £'000*
Authorised:		
40,000,000 Ordinary Shares of 25p	10,000	10,000
Allotted, called up and fully paid:		
29,600,002 Ordinary Shares of 25p	7,400	7,400

Notes to the Financial Statements

for the year ended 31 December 2005

17. Reserves

The special reserve was created when the Company cancelled part of its share premium account, transferring it to a distributable reserve to allow the buy-back and cancellation of up to 14.99% of the Ordinary Shares.

The capital reserve comprises an unrealised capital reserve of £25,816,830 (2004: £17,586,421) and a deficit on the realised capital reserve of £(9,770,940) (2004: £(11,957,357)).

18. Net asset value per Ordinary Share

	2005 *pence*	*2004 (restated)* *pence*
Balance at 1 January as previously stated	140.51	126.12
Prior year adjustment	(2.03)	(2.78)
Opening net asset value per Ordinary Share	138.48	123.34
Total return per Ordinary Share	44.26	24.14
Dividend per Ordinary Share	(9.00)	(9.00)
Closing net asset value per Ordinary Share	173.74	138.48

The net asset value per Ordinary Share is based on the net assets attributable to equity Shareholders of £51,427,357 (2004: £40,990,327) and on 29,600,002 (2004: 29,600,002) Ordinary Shares in issue at the end of the year.

These financial statements have been prepared in accordance with the provisions of FRS 26. The effect of this is to bring into the Balance Sheet the concept of "fair value", with the Company's investment portfolio being valued at bid market prices. However, in accordance with the SORP for ITCs (prior to its December 2005 revision), the net asset value reported each month to the London Stock Exchange and The Channel Islands Stock Exchange reflected these investments valued at Stock Exchange quoted market mid prices. The monetary effects of FRS 26 have resulted in a reduction in the net asset value per Ordinary Share of 2.30p (2004: 2.03p).

From the start of 2006, and in accordance with the recommendations of the Association of Investment Trust Companies ("AITC"), the net asset values reported each month to the London Stock Exchange and The Channel Islands Stock Exchange will reflect the Company's investments valued at Stock Exchange quoted market bid prices and mid prices.

Reconciliation of net asset value to published net asset value:

	2005 Total £'000	*2005 Per Share pence*	*2004 Total £'000*	*2004 Per Share pence*
Published net asset value[1]	52,108	176.04	41,591	140.51
Valuation of investments at bid prices	(681)	(2.30)	(601)	(2.03)
Net asset value per FRS 26	51,427	173.74	40,990	138.48

[1]*Valued at mid prices.*

Notes to the Financial Statements

for the year ended 31 December 2005

19. Reconciliation of net revenue return before finance costs and taxation to net cash inflow from operating activities

	2005 *£'000*	*2004* *(restated)* *£'000*
Net revenue return before finance costs and taxation	3,057	2,622
Management fee charged to the capital reserve	(529)	(487)
Transaction costs charged to the capital reserve	(111)	(199)
Decrease/(increase) in accrued income	102	(17)
Decrease in other debtors	1	2
Increase in other creditors and accruals	13	11
Net cash inflow from operating activities	2,533	1,932

20. Reconciliation of net cash flow to net debt

	1 January *2005* *£'000*	*Cash flows* *£'000*	*Other* *£'000*	*31 December* *2005* *£'000*
Cash at bank and in hand	4,242	996	–	5,238
Debt due in less than one year	–	–	(25,616)	(25,616)
Debt due after more than one year	(25,616)	–	25,616	–
Total	(21,374)	996	–	(20,378)

21. Capital commitments

All contracted capital commitments have been provided for.

22. Related parties

Details of the relationships between the Company, Collins Stewart Fund Management Limited, Collins Stewart Portfolio Management Limited and Collins Stewart (CI) Limited are disclosed in the Report of the Directors and note 6.

The Company receives stockbroking services from Collins Stewart Limited in respect of its London Stock Exchange listing, for which a fee of £6,250 per annum is paid, and from Collins Stewart (CI) Limited in respect of The Channel Islands Stock Exchange listing, for which a fee of £6,250 per annum is paid.

The Company paid Collins Stewart (CI) Limited £39,102 (2004: £37,731) in respect of the Custodian services provided.

Collins Stewart (CI) Limited, Collins Stewart Fund Management Limited and Collins Stewart Limited are all members of the Collins Stewart Tullett plc Group.

The Directors are not aware of any ultimate controlling party.

23. Risk profile of financial assets and liabilities

Financial Summary

The principal investment objectives of the Company are to provide Shareholders with a high income and also the opportunity for income and capital growth by investing primarily in smaller capitalised United Kingdom companies admitted to the Official List of the United Kingdom Listing Authority and traded on the London Stock Exchange or traded on AIM.

Notes to the Financial Statements

for the year ended 31 December 2005

23. Risk profile of financial assets and liabilities (continued)

Financial Summary (continued)

The Company's portfolio is invested in equities and high income and fixed interest and other income-bearing securities in order to achieve its investment objectives. It is the aim of the Company to provide both income and capital growth predominantly through investment of approximately 75% of the portfolio in smaller capitalised United Kingdom companies. The Company also aims to further enhance income for Shareholders by investing approximately 25% of its assets in a Sterling denominated investment grade fixed interest bond portfolio. Due to the recent performance of the Smaller Companies Portfolio and the testing conditions faced by the Sterling bond market the split has been relaxed to be closer to 80% invested in smaller capitalised United Kingdom companies, whilst the remainder is invested in Sterling denominated investment grade fixed interest bonds and cash.

It is no longer the policy of the Company to invest in ordinary shares and income shares of split capital investment trusts nor lower grade fixed interest Sterling denominated debt and convertibles. At 31 December 2005 78.54%, (2004: 80.04%) of the portfolio (including cash) related to the smaller companies portfolio.

In addition, the Company holds cash and liquid resources as well as having debtors and creditors that arise directly from its operations.

The main risks arising from the Company's financial instruments are market price risk, interest rate risk and liquidity risk. As all the assets and liabilities of the Company are denominated in Sterling, there is no currency risk.

Market price risk

The Company's exposure to market price risk consists mainly of movements in the value of the Company's investments. The Company's investment portfolio complies with the investment parameters as disclosed in its prospectus and the spread of the principal investments is disclosed on pages 6 and 7. The Board manages the market price risks inherent in the investment portfolios by ensuring full and timely access to relevant information from the Investment Advisers. The Board meets regularly and at each meeting reviews investment performance.

The magnitude of any change in the net asset value of the portfolio arising from market price movements is increased by the Company's policy of employing gearing. A 10% increase/decrease in the market prices of investments would have resulted in a 14.01% (2004: 15.03%) increase/decrease in the net asset value per Ordinary Share as at the balance sheet date.

Interest rate risk

The Company finances its operations through a mixture of shareholders' capital, bank borrowings and retained profits. Bank of Scotland International has made available a term loan of up to £25,616,000. The interest payable under the facility is fixed at regular intervals based on the aggregate rate of LIBOR plus certain additional regulatory costs charged by the bank and a margin of 1.0% per annum (see note 15).

Liquidity risk

The Company entered into a loan agreement with Bank of Scotland International, under which Bank of Scotland made available a loan of £25,616,000 (see note 15). The Company has extended the repayment date of the loan from 11 February 2006 to 31 October 2006. The terms of the Company's bank borrowings entitle the lender to require early repayment should the Company breach any of the covenants placed upon it by Bank of Scotland.

The Company's liquidity is monitored regularly to ensure that the covenants are not breached.

Certain of the Company's investments are or may be illiquid, and the marketability of investments that are normally liquid may be affected by unsettled market conditions.

Notes to the Financial Statements

for the year ended 31 December 2005

23. Risk profile of financial assets and liabilities (continued)

Interest rate risk – profile

The Company's financial fixed assets comprise a fixed interest portfolio of £7,393,575 (2004: £8,245,888) with a weighted average coupon rate of 8.31% (2004: 9.03%), fixed for a weighted average period of 6.03 years (2004: 4.21 years). An investment with a market value of £778,400 (2004: £801,430) with a fixed income of 9.875% is undated.

The balance of the investment portfolio consists of non-interest bearing investments of £64,681,712 (2004: £53,370,572).

The Company's other exposure to interest rate risk arises through its loan, details of which are given in note 15.

Financial assets

	Non-interest bearing 2005 £'000	*Fixed rate 2005 £'000*	*Floating rate 2005 £'000*	*Total 2005 £'000*	*Non-interest bearing (restated) 2004 £'000*	*Fixed rate (restated) 2004 £'000*	*Floating rate (restated) 2004 £'000*	*Total (restated) 2004 £'000*
Equity shares	61,681	–	–	61,681	53,370	–	–	53,370
Debt investments	–	7,394	3,000	10,394	–	8,246	–	8,246
Cash at bank	–	–	5,238	5,238	–	–	4,242	4,242
	61,681	7,394	8,238	77,313	53,370	8,246	4,242	65,858

The above analysis excludes short-term debtors as all the material amounts are non-interest bearing.

Fixed rate financial assets

	Weighted average rate 2005 %	*Weighted average period 2005 years*	*Weighted average rate 2004 %*	*Weighted average period 2004 years*
Debt investments	8.31	6.03	9.03	4.21

Financial liabilities

	Fixed rate financial liabilities 2005 £'000	*Fixed rate financial liabilities 2004 £'000*
Bank loan	25,616	25,616

The above analysis excludes short-term creditors as all the material amounts are non-interest bearing. The Company has extended the repayment date of the bank loan from 11 February 2006 to 31 October 2006.

Credit risk

The risk that counterparties might default on their obligations is monitored on an ongoing basis. As stated in the Prospectus, it is the Company's policy not to invest more than 20% of the gross assets of the Company in the securities of any one company or group at the time the investment is made.

The Group's principal financial assets are equity shares, cash at bank and other receivables. The Company has no significant concentration of credit risk, with exposure spread over a large number of counterparties. At 31 December 2005 the Company's largest exposure to a single investment was £5,792,000, 11.26% of total assets (2004: £5,096,000, 12.43%).

Directors and Advisers

David Martin Bralsford (Chairman)

Mr Bralsford is aged 58 and a resident of Jersey. He is currently chief executive of CI Traders Limited, having previously been managing director of Premier Brands Limited, whom he joined from Cadbury Schweppes plc. He is currently chairman of Close Brothers Protected VCT plc and a director of a number of private companies.

John Campbell Boothman

Mr Boothman is aged 53 and is a resident of Jersey. He is currently non-executive chairman of Aztec Financial Services Limited and a non-executive director of Jersey Telecom Group Limited. He was managing director of Deutsche Bank International Limited from 1994 to 2002 and he also acted as a director of Deutsche Bank Group Companies in the United Kingdom, Jersey, Guernsey and the Cayman Islands. Prior to that he was banking and treasury director.

John Michael McKean

Mr McKean is aged 74 and is a resident of Guernsey. He is a solicitor and also a non-executive director of other Guernsey registered funds.

Shane Raymond Le Prevost

Mr Le Prevost is aged 50 and is Chief Executive Officer of Collins Stewart Limited. He is also a director of Collins Stewart Portfolio Management Limited and Collins Stewart Fund Management Limited.

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