P&O Scottish Ferries Limited

Directors' report and financial statements

Registered number 71375

31 December 2004

Contents

Directors' Report

The directors present their annual report and audited financial statements for the year ended 31 December 2004.

Principal activities, review of business and future developments

The company's principal activities were ship owning and operation of ferry services. The company ceased trading on 11 November 2002. The Industrial Tribunal considering the release of the company staff and the obligations of the ferry operator who took over the business activity of the company published its conclusion in June 2004, but this conclusion was subject to an appeal which was heard in February 2005. The appeal was dismissed on all counts, thus the findings of the Tribunal were confirmed, namely that all employees should have been transferred to the new service provider under substantially the same terms and conditions as they had enjoyed with P&O Scottish Ferries Ltd.
It is the intention of the directors to make the company dormant.

Results and dividends

The company's results are shown in the Profit and Loss Account on page 5.

The directors recommend a total dividend for the year of £9,672,000 (2003: £1,922,000)

Directors and directors' interests

The directors who held office during the year were as follows:

T.C.Cairns
H.Stapleton (resigned 4th March 2004)
R.M.Gradon (appointed 13th February 2004)

None of the directors who held office at the end of the financial year had any disclosable interest in the shares of the company.

According to the notifications received by the company relating to the interests of the directors at 31 December 2004 and their families in the share capital and debentures of group companies, there were the following interests in the stock of the ultimate holding company, The Peninsular and Oriental Steam Navigation Company:

	Deferred Stock		Deferred stock under option				
	2004	2003	2004	Exercised during the year	Granted during the year	Surrendered during the year	2003
	£	£	£	£	£	£	£
T.C.Cairns	7,205	7,205	97,185	21,894	-	-	119,079

Details of shares held by R.M.Gradon are disclosed in the accounts of the ultimate parent company.

Directors' Report *(continued)*

Employees

The Company had no employees in the year.

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditor of the company is to be proposed at the forthcoming Annual General Meeting.

By order of the board

Secretary

13 October 2005

Statement of Directors' Responsibilities

Company law requires the directors to prepare financial statements 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 financial statements, the directors are required to;

a) select suitable accounting policies and then apply them consistently;

b) make judgements and estimates that are reasonable and prudent;

c) state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and

d) prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business. As explained in note 1 to the financial statements, the directors do not believe the going concern basis to be appropriate and these financial statements have not been prepared on that basis.

The directors are 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 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.

Independent Auditor's report to the members of P&O Scottish Ferries Limited

We have audited the financial statements on pages 5 to 15.

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 directors' report and, as described on page 3, the financial statements 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 financial statements 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 financial statements, 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.

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 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 of the state of the company's affairs as at 31 December 2004 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Registered Auditor
Chartered Accountants

London
27 October 2005

Profit and Loss Account
for the year ended 31 December 2004

	Note	2004 £'000	2003 £'000
Turnover			
Discontinued operations	1	-	9
Staff costs	4	-	(7)
Depreciation		-	(3)
Other operating income		73	106
Operating profit		73	105
Profit on other asset disposals		-	18
Seafarers Pension Contribution		(1,762)	-
		(1,689)	123
Interest receivable	5	888	977
(Loss) / profit on ordinary activities before taxation	2-4	(801)	1,100
Taxation	6	(274)	(422)
(Loss) / profit for the financial year		(1,075)	678
Dividend on equity shares		(9,672)	(1,922)
Retained loss for the year	13	(10,747)	(1,244)

There is no material difference between the profit for the financial year as reported and that calculated on an unmodified historical cost basis.

There are no recognised gains or losses other than the loss for the financial year.

The results for 2004 and 2003 wholly relate to discontinued operations.

Balance Sheet
at 31 December 2004

	Note	2004 £'000	2004 £'000	2003 £'000	2003 £'000
Fixed assets					
Investments	*7*		403		403
			403		403
Current assets					
Debtors	*8*	173		69	
Cash at bank and in hand		10,103		19,948	
		10,276		20,017	
Creditors: amounts falling due within one year	*9*	(1,967)		(805)	
Net current assets			8,309		19,212
Total assets less current liabilities			8,712		19,615
Provisions for liabilities and charges	*10*		(170)		(326)
Net assets			8,542		19,289
Capital and reserves					
Called up share capital	*12*		8,148		8,148
Profit and loss account			394		11,141
Equity shareholders' funds			8,542		19,289

These financial statements were approved by the Board of directors on 13 October 2005 and were signed on its behalf by:

R. M. Gradon
Director

Reconciliation of movements in equity shareholders' funds

	2004 £'000	2003 £'000
(Loss) / profit for the financial year	(1,075)	678
Dividends	(9,672)	(1,922)
Net reduction in equity shareholders' funds	(10,747)	(1,244)
Opening equity shareholders' funds	19,289	20,533
Closing equity shareholders' funds	8,542	19,289

Notes
(forming part of the financial statements)

1. Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements.

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under historical cost accounting rules, modified to include the revaluation of certain land and buildings. The accounts have been prepared to reflect the discontinuation of the business. The company's principal source of revenue was from the provision of ferry services that terminated in 2002. Accordingly the company is being closed down.

The company is exempt by virtue of s228 of the Companies Act 1985 from the requirement to prepare group financial statements. These financial statements present information about the company as an individual undertaking and not about its group.

Under Financial Reporting Standard 1, the company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent company undertaking includes the company in its own published consolidated financial statements.

As the company is a wholly owned subsidiary of The Peninsular and Oriental Steam Navigation Company, the company has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the group (or investees of the group qualifying as related parties).

Analysis of turnover

Turnover represents the value of ferry services supplied (excluding value added tax) on the routes to Orkney and Shetland from the UK mainland during the previous year.

Pension Schemes

Contributions for ongoing benefit accruals paid to schemes in respect of defined benefit pension schemes are calculated as a percentage, agreed on actuarial advice, of the pensionable salaries of employees. The cost of providing defined benefit pensions is charged to the profit and loss account on a systematic basis over the periods benefiting from the services of employees. Differences between the amounts charged to the profit and loss account and payments made to the pension schemes are treated as assets or liabilities.
Contributions including lump sum payments in respect of defined contribution pension schemes and multi employer defined benefit schemes, where it is not possible to identify the Company's share of the scheme, are charged to the profit and loss account when they are payable.

Notes *(continued)*

2. (Loss) / profit on ordinary activities before taxation

(Loss) / profit on ordinary activities before taxation is stated after charging:

	2004 £'000	2003 £'000
Depreciation written off owned tangible fixed assets	-	3
Operating lease rentals payable		
Land and buildings	-	9

3. Emoluments of directors

	2004 £'000	2003 £'000
	-	41

4. Employees

The average number of persons employed by the company (including directors) during the year, was as follows:

	Number of emloyees	
	2004	2003
Shore staff	-	1

	2004 £,000	2003 £'000
Social security costs	-	7
	-	7

Anticipated wages and salaries, social security and pension costs for 2003 were accounted for within the Provision for Future Closure Costs in the 2002 accounts, they amounted to of £82,000. The figures above exclude costs relating to sea staff, as these costs are borne by another group company. These costs are included within other operating charges. Pension costs totalled £1,762,000 (2003 £Nil), (See note 14)

Notes *(continued)*

5. Interest receivable and similar income

	2004 £'000	2003 £'000
Bank interest receivable	888	977

6. Taxation

Analysis of charge in period	2004 £'000	2003 £'000
UK corporation tax		
Current tax on income for the period	266	324
Adjustments in respect of prior periods	8	98
Tax on loss on ordinary activities	274	422

Factors affecting the total current tax charge
The current tax charge for the period is higher (2003: higher) than the standard rate of corporation tax in the UK 30%. The differences are explained below

Analysis of charge in period	2004 £'000	2003 £'000
Current tax reconciliation		
(Loss) / profit on ordinary activities before tax	(801)	1,100
Current tax at 30% (2003: 30%)	(240)	330
Effects of:		
Tax release on disposal of company assets	-	(6)
Tonnage tax	506	-
Adjustments to tax charge in respect of previous periods	8	98
Total current tax charge	274	422

Notes *(continued)*

7. Investments

	Shares in group undertakings £'000	Other unlisted investments £'000	Total £'000
Cost			
At beginning and end of year	400	3	403

The company holds 100% of the ordinary share capital of P&O Scottish Ferries Ship Management Limited, which is incorporated in Great Britain and registered in Scotland.

In the opinion of the directors the investments in subsidiary undertakings are worth at least the amounts at which they are stated in the balance sheet.

8. Debtors

	2004 £'000	**2003 £'000**
Amounts falling due within one year:		
Other taxes and social security	3	33
Prepayments and accrued income	170	36
	173	69

9. Creditors: amounts falling due within one year

	2004 £'000	**2004 £'000**	**2003 £'000**	**2003 £'000**
Trade creditors		2		29
Amounts owed to subsidiary		400		400
External pension scheme		1,289		-
Other creditors including taxation and social security				
Corporation tax	266		324	
Other taxes and social security	-		3	
Taxation and social security	266		327	
Other creditors	-		1	
		266		328
Accruals		10		48
		1,967		805

Notes *(continued)*

10. Provisions for liabilities and charges and contingent liabilities

	2004 £'000	2003 £'000
Future closure costs		
At beginning of year	326	726
Utilised during year	(156)	(400)
At end of year	170	326

11 Contingent liabilities

In addition to the provision of £170,000 (2003 £326,000) for future closure costs, at the year end the directors are aware of certain contingent liabilities of the company related to the closure of its business.

12. Share capital

	2004 £'000	2003 £'000
Authorised		
1,000,000 ordinary shares of £10 each	10,000	10,000
	£'000	£'000
Allotted, called up and fully paid		
814,800 Ordinary shares of £10 each	8,148	8,148

13. Reserves

Profit and loss account	£'000
1 January 2004	11,141
Retained loss for the financial year	(10,747)
At 31 December 2004	394

Notes *(continued)*

14. Pension schemes

The company participated in the funded UK P&O Pension Scheme ("the P&O scheme"), which is a defined benefit scheme and was closed to routine new members on 1 January 2002. The assets of the scheme are managed on behalf of the trustee by independent fund managers.

The company also makes contributions to various industry schemes which have assets in separate trustee administered funds.

The pension charge for the year was:

	2004 £'000	2003 £'000
The P&O Scheme	-	-
Merchant Navy pension schemes	1,762	-
	1,762	-

P&O Ferries Limited, a fellow subsidiary, agreed to take on the liability for any P&O Pension Scheme deficit payments relating to P&O Scottish Ferries Limited from 1 January 2003 and the Company is therefore accounting for the P&O Scheme under both SSAP 24 and FRS 17 as if it were a defined contribution scheme.

Industry Schemes

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

Merchant Navy Ratings Pension Fund ("MNRPF")

The MNRPF is a defined benefit multi-employer scheme in which sea staff employed by the company formerly participated. The company left the scheme in 1998 settling its statutory debt obligation in 1999. The scheme has a funding deficit and has been closed to further benefit accrual.
As at 31 March 2002, the date of the most recent full triennial actuarial valuation carried out by an independent actuary, the scheme had assets with a market value of £506m, representing 84 per cent of the benefits accrued to members allowing for future increases. The scheme had however exceeded its minimum funding requirement at that date. Approximately 66 per cent of the scheme's assets were invested in bonds, 23 per cent in equities and 11 per cent in property and cash. The valuation assumptions were as follows:

	%
Discount rate	5.8
Rate of salary increases	4.0
Rate of pension increases (where increases apply)	2.5
Expected return on assets	5.8

As a result of this valuation a revised fixed schedule of payments has been drawn up which remains in place until 31 March 2007. While the company is no longer a current employer in the MNRPF, and has no legal obligation with respect to the on-going deficit in the fund, having settled its statutory debt obligation, it is participating on a voluntary basis to the fixed schedule of payments. These payments are included within the merchant navy pension schemes charge on page 13.

Notes *(continued)*

14. Pension schemes *(continued)*

For the year ended 31 December 2004 the company cannot identify its share of the underlying assets and liabilities of the MNRPF on a consistent and reasonable basis and is therefore for the year ended 31 December 2004 accounting for the MNRPF under both SSAP24 and FRS17 as if it were a defined contribution scheme.

Merchant Navy Officers Pension Fund ("MNOPF")

The MNOPF is a defined benefit multi-employer scheme in which officers employed by the company have participated and continue to participate.

The scheme is divided into two sections, the Old Section and the New Section both of which are closed to new members and the latest valuation was carried out at 31 March 2003.

The Old Section has been closed to benefit accrual since 1978. The scheme's independent actuary advised that at 31 March 2003 the market value of the scheme's assets for the Old Section was £1,316m, representing approximately 115 per cent of the value of the benefits accrued to members on the valuation basis. The assets of the Old Section were substantially invested in bonds.

As at 31 March 2003 the date of the most recent formal actuarial valuation, the New Section had assets with a market value of £1,168m, representing approximately 86 per cent of the benefits accrued to members. The valuation assumptions were as follows:

	%
Discount rate	7.8
Rate of salary increases	4.0
Rate of pension increases (where increases apply)	2.5
Expected return on assets	7.8

At the date of the valuation, approximately 59 per cent of the New Section's assets were invested in equities, 28 per cent in bonds and 13 per cent in property and cash.

It is unclear how the deficit will be allocated between employers and there has been a court case to establish the principles by which the deficit payments required to meet this deficit should be funded. Based on information provided by the Trustee, the company's share of the deficit could be 1.2 per cent, with these figures potentially increasing if payments from other employers are not forthcoming.

For the year ended 31 December 2004 for both SSAP 24 and FRS17 purposes although the employers' contributions to the MNOPF would be affected by a surplus or deficit in the scheme, the company is unable to identify its share of the underlying assets and liabilities on a consistent and reasonable basis. The company has therefore accounted for contributions to the MNOPF as if it were a defined contribution scheme.

Notes *(continued)*

15. Immediate and Ultimate Parent Undertaking

The company's ultimate parent holding company is The Peninsular and Oriental Steam Navigation Company, which is incorporated by Royal Charter in Great Britain and therefore not registered.

The largest group in which the results of the company are consolidated is that headed by The Peninsular and Oriental Steam Navigation Company. The consolidated financial statements of The Peninsular and Oriental Steam Navigation Company are available to the public and may be obtained from the Registrar of Companies, Companies House, Crown Way, Cardiff, CF4 3UZ.

No other group financial statements include the results of the company.