

Directors' report

Principal activity 3i Group plc is a world leader in private equity and venture capital. The principal activity of the Company and its subsidiaries ("the Group") is investment. It invests in a wide range of growing independent businesses. Its objective is to maximise shareholder value through growth in total return.

Tax and investment company status The Company is an investment company as defined by section 266 of the Companies Act 1985 and carries on business as an investment trust.

The Inland Revenue has approved the Company as an investment trust under section 842 of the Income and Corporation Taxes Act 1988 for the financial period ended 31 March 2003. Since that date, the Company has directed its affairs to enable it to continue to be so approved.

Regulation The Company is authorised and regulated by the Financial Services Authority as a deposit taker. 3i Investments plc and 3i Japan GP Limited, both wholly owned subsidiaries of the Company, are authorised persons under the Financial Services and Markets Act 2000 and regulated by the Financial Services Authority.

Where applicable, certain Group subsidiaries' businesses outside the United Kingdom are regulated by relevant authorities.

Results and dividends The accounts of the Company and the Group for the year to 31 March 2004 appear on pages 47 to 68.

Consolidated total return for the period was £531 million (2003: negative sum of £935 million). An interim dividend of 5.1p per share was paid on 7 January 2004. The Directors recommend a final dividend of 8.9p per share be paid in respect of the year to 31 March 2004 to shareholders on the register at the close of business on 18 June 2004.

By a deed of waiver dated 9 June 1994, Mourant & Co. Trustees Limited as trustee of The 3i Group Employee Trust waived (subject to certain minor exceptions) all dividends declared by the Company after 26 May 1994 in respect of shares from time to time held by it (currently 9,859,472 shares) as trustee of that trust.

Operations The Company owns substantially all the Group's investments. The Group operates through a network of 31 offices across Europe, Asia Pacific and the US.

The Group manages a number of funds established with major institutions and pension funds to make equity and equity related investments in unquoted businesses in Europe and Asia Pacific.

3i Investments plc acts as investment manager to the Company and certain of its subsidiaries. 3i Investments plc also acts as investment manager to 3i Smaller Quoted Companies Trust plc, 3i Bioscience Investment Trust plc and 3i European Technology Trust plc, investment trusts listed on the London Stock Exchange. 3i Investments plc also manages the 3i Group Pension Plan.

Business review The Chairman's statement on pages 2 and 3, the Chief Executive's statement on pages 4 and 5 and the Operating and financial review on pages 8 to 24 report on the Group's development during the year to 31 March 2004, its position at that date and the Group's likely future development.

Share capital In the year to 31 March 2004, the issued share capital of the Company increased by 2,560,906 shares to 613,479,159 shares as a result of the issue of shares to the trustee of The 3i Group Share Incentive Plan, the exercise of options under the 3i executive share option plans and The 3i Group Sharesave Scheme and the issue of shares to the nine vendors of SFK Finance Oy.

Major interests in shares As at 4 May 2004, the Company had been notified of the following interests in the Company's shares in accordance with sections 198 to 208 of the Companies Act 1985:

	%	Number of shares
FMR Corporation and Fidelity International Limited and their subsidiary companies	9.02	55,332,661
Prudential plc and subsidiary companies	5.99	36,755,893
Legal & General Investments Management Limited	3.41	20,914,010

Directors' interests Details of the Directors' interests in the Company's shares are shown in note 40 to the accounts on page 65.

Save as shown in note 40 on page 65, no Director had any disclosable interest in the shares, debentures or loan stock of the Company or in the shares, debentures or loan stock of its subsidiaries during the period. Save as shown in note 40 on page 65, there have been no changes in the above interests between 31 March 2004 and 4 May 2004. No Director was materially interested in any contract or arrangement subsisting during or at the end of the financial period that was significant in relation to the business of the Company.

Directors' service contracts Details of Directors' employment contracts are set out in the Remuneration report on page 44.

Management arrangements 3i plc provides the Group with certain corporate and administrative services, for which no regulatory authorisation is required, under contracts which provide for fees based on the work done and costs incurred in providing such services. The contract between 3i plc and 3i Investments plc may be terminated by either party on three months' notice. The contracts between 3i plc and other Group companies may be terminated by either party on reasonable notice.

3i Investments plc provides the Group with investment management and other services, for which regulatory authorisation is required, under contracts which provide for fees based on the work done and costs incurred in providing such services. These contracts may be terminated by either party on reasonable notice.

Corporate governance Throughout the year to 31 March 2004, the Company complied with the provisions of section 1 of the Combined Code on corporate governance issued by the Hampel Committee on Corporate Governance in June 1998 ("the Combined Code"). The Company has already taken steps to enable it to comply, with effect from 1 April 2004, with the new Combined Code ("the new Combined Code") published by the Financial Reporting Council in July 2003.

The Company's approach to corporate governance The Company has a policy of seeking to comply with established best practice in the field of corporate governance. The Board has adopted core values and Group standards which set out the behaviours expected of staff in their dealings with shareholders, customers, colleagues, suppliers and other stakeholders of the Company. One of the core values communicated within the Group is a belief that the highest standard of integrity is essential in business.

The Board's responsibilities and processes The Board is responsible to shareholders for the overall management of the Group. It determines matters including financial strategy and planning and takes major business decisions.

The Board has approved a formal schedule of matters reserved to it and its duly authorised Committees for decision. These include:

- approval of the Group's overall strategy, annual operating budget and strategic plan;
- approval of the Company's interim and final accounts and changes in the Group's accounting policies or practices;
- changes relating to the capital structure of the Company or its status as a regulated entity;
- major capital projects;
- major changes in the nature of business operations;
- investments and divestments in the ordinary course of business above certain limits set by the Board from time to time;
- adequacy of internal control systems;
- appointments to the Board and Executive Committee;
- principal terms and conditions of employment of members of Executive Committee;
- changes in employee share schemes and carried interest schemes.

Matters delegated to management include implementation of the Board approved strategy, day to day operation of the business, the appointment of all executives below Executive Committee and the formulation and execution of risk management practices and policies.

The Board has put in place an organisational structure. This is further described below under the heading "internal control".

A Group succession and contingency plan is prepared by management and reviewed annually by the Board. The purpose of this plan is to identify suitable candidates for succession to key senior management positions, agree their training and development needs, and ensure the necessary human resources are in place for the Company to meet its objectives.

During the year, there were six regular meetings of the Board of Directors. All the Directors attended those meetings.

The roles of the Chairman and the Chief Executive The division of responsibilities between the Chairman of the Board, Baroness Hogg, and the Chief Executive, Mr B P Larcombe, is clearly defined and has been approved by the Board.

The Chairman

The Chairman leads the Board in the determination of its strategy and in the achievement of its objectives. The Chairman is responsible for organising the business of the Board, ensuring its effectiveness and setting its agenda. The Chairman has no involvement in the day to day business of the Group. The Chairman facilitates the effective contribution of non-executive Directors and constructive relations between executive and non-executive Directors.

The Chairman ensures that regular reports from the Company's brokers are circulated to the non-executive Directors to enable non-executive Directors to remain aware of shareholders' views. Through involvement in the interim and full year reporting process, the Company's results presentations and the Company's Annual General Meeting, the Chairman ensures effective communication with the Company's shareholders.

The Chief Executive

The Chief Executive has direct charge of the Group on a day to day basis and is accountable to the Board for the financial and operational performance of the Group. The Chief Executive has formed a management committee called Executive Committee to enable him to carry out the responsibilities delegated to him by the Board. The Committee comprises the executive Directors, the Company Secretary, Mr C P Rowlands, Mr J B C Russell and Mr P Waller. The Committee meets on a regular basis to consider operational matters and the implementation of the Group's strategy.

Senior Independent Director The Board has appointed Mr O H J Stocken as Senior Independent Director, to whom, in accordance with the Combined Code, concerns can be conveyed.

Directors The Board currently comprises the Chairman, five independent non-executive Directors and four executive Directors. The names of the Directors together with their biographical details are set out on pages 30 and 31. All the Directors served throughout the period under review.

In addition to fulfilling the legal responsibilities of a director, a non-executive Director is expected to bring an independent judgment to bear on issues of strategy, performance, resources and standards of conduct and to help the Board provide the Company with effective leadership. In addition, a non-executive Director is expected to ensure high standards of financial probity on the part of the Company and monitor the effectiveness of the executive Directors.

The Board's discussions, and its approval of the Group's rolling strategic plan and annual budget, provide the non-executive Directors with the opportunity to challenge the Company's management and assist in the development of strategy. The non-executive Directors receive monthly management accounts and regular management reports and information which enable them to scrutinise the Company's and management's performance against agreed objectives. This is further described below under the heading "internal control".

Directors' independence All the non-executive Directors, including the Chairman, are considered by the Board to be independent for the purposes of the new Combined Code. The Board assesses and reviews the independence of each of the non-executive Directors at least annually having regard to the potential relevance and materiality of a Director's interests and relationships rather than applying rigid criteria in a mechanistic manner. The Board has considered Mr O H J Stocken and Mme C J M Morin-Postel's common directorship of Pilkington plc and concluded that it does not affect their independence.

The Board's Committees The Board is assisted by various specialised committees of the Board which report regularly to the Board. The membership of these Committees is regularly reviewed by the Board. When considering committee membership and chairmanship, the Board aims to ensure that undue reliance is not placed on particular Directors.

These Committees all have clearly defined and written terms of reference. The terms of reference of the Audit and Compliance Committee, the Remuneration Committee and the Nominations Committee provide that no one other than the Committee Chairman and members may attend a meeting unless invited to attend by the Committee.

Details of the work of these Committees are set out below.

Audit and Compliance Committee During the year, the Audit and Compliance Committee comprised Mr O H J Stocken (Chairman), Dr J R Forrest, Mme C J M Morin-Postel and Mr F D Rosenkranz, all independent non-executive Directors. The Board is satisfied that the Committee Chairman, Mr Stocken, has recent and relevant financial experience.

The terms of reference of the Audit and Compliance Committee are available on the Company's website.

The Committee reviews the effectiveness of the internal control environment of the Group and the Group's compliance with its regulatory requirements. Further details of this work are described below under the heading "internal control".

The Committee receives regular reports from the internal and external auditors, the regulatory compliance function and Risk Committee, details of which are described below under the heading "internal control", and monitors their activities and effectiveness. The Committee reviews the interim and annual accounts of the Company before their approval by the Board and reviews the scope of the annual audit and any audit findings. The Committee also oversees the Company's relations with its external auditors and recommends to the Board the appointment, reappointment and removal of the Company's auditors and approves the terms of their engagement and their fees. The Committee meets with the heads of the internal audit and compliance functions, and the external auditors, at least once a year in the absence of management.

The Committee also reviews the Company's "whistle blowing policy" to ensure that arrangements are in place for staff to raise, in confidence, matters of concern, for an appropriate and independent investigation of such matters and, where necessary, for follow-up action.

During the year, there were four meetings of the Audit and Compliance Committee. All members of the Committee attended those meetings, other than Mme C J M Morin-Postel who attended three meetings.

Remuneration Committee During the year, the Remuneration Committee comprised Dr J R Forrest (Chairman), Baroness Hogg (who ceased to be a member on 31 March 2004), Mr O H J Stocken and Mr F D Rosenkranz. On 1 April 2004, Mr F D Rosenkranz became the Chairman, and Mme C J M Morin-Postel was appointed a member, of the Committee. All the members of the Committee are independent non-executive Directors.

The terms of reference of the Remuneration Committee are available on the Company's website.

Details of the work of the Remuneration Committee are set out in the Remuneration report.

During the year, there were seven meetings of the Remuneration Committee. All members of the Committee attended those meetings, other than Dr J R Forrest who attended six meetings.

Nominations Committee During the year, the Nominations Committee comprised Baroness Hogg (Chairman), Dr J R Forrest, Mr B P Larcombe, Mme C J M Morin-Postel, Mr F D Rosenkranz, Mr F G Steingraber and Mr O H J Stocken. Mr R W Perry has been co-opted to assist the Committee in the appointment of a new Chief Executive.

The terms of reference of the Nominations Committee are available on the Company's website. These provide that the Chairman shall not chair the Committee when dealing with the appointment of the Chairman's successor.

The Nominations Committee and the Board regularly review the composition of the Board to ensure the balance of its membership, as between executive and non-executive Directors, and its profile, in terms of size and length of service and experience of individual Directors, remain appropriate. A formal, rigorous and transparent process for the appointment of Directors has been established with the objective of identifying the skills and experience profile required of new Directors and identifying suitable candidates. The procedure includes the appraisal and selection of potential candidates, including (in the case of non-executive Directors) whether they have sufficient time to fulfil their roles. Where appropriate, specialist recruitment consultants assist the Committee to identify suitable candidates for appointment. The Committee's recommendations for appointment are put to the full Board for approval.

Following the appointment of new non-executive Directors, the Company's major shareholders will be offered the opportunity to meet them.

During the year, there were three meetings of the Nominations Committee. All members of the Committee attended those meetings, save that Mr B P Larcombe did not attend when succession to the post of Chief Executive was discussed. Mr R W Perry attended one meeting of the Committee.

Valuations Committee During the year, the Valuations Committee comprised Baroness Hogg (Chairman), Dr J R Forrest, Mr B P Larcombe, Mr M J Queen and Mr O H J Stocken.

The Valuations Committee considers and recommends to the Board the valuations of the Group's investments to be included in the interim and final accounts of the Group and changes to valuations policy.

During the year, there were three meetings of the Valuations Committee. All members of the Committee attended those meetings.

The Company Secretary The Company Secretary is responsible for advising the Board, through the Chairman, on governance matters. All Directors have access to the advice and services of the Company Secretary. The Company's Articles of Association and the schedule of matters reserved to the Board for decision provide that the appointment and removal of the Company Secretary is a matter for the full Board.

Information Regular reports and papers are circulated to the Directors in a timely manner in preparation for Board and Committee meetings. These papers are supplemented by information specifically requested by the Directors from time to time.

Directors' training and development The Company has developed a training policy which provides a framework within which training for Directors is planned with the objective of ensuring Directors understand the duties and responsibilities of being a director of a listed company. All Directors are required to update their skills and maintain their familiarity with the Company and its business continually. Presentations on different aspects of the Company's business are made regularly to the Board. On appointment, all non-executive Directors have discussions with the Chairman and the Chief Executive following which appropriate briefings on the responsibilities of Directors, the Company's business and the Company's procedures are arranged. The Company provides opportunities for non-executive Directors to obtain a thorough understanding of the Company's business by meeting members of the senior management team who in turn arrange, as required, visits to investment offices and support departments.

The Company has procedures for Directors to take independent legal or other professional advice about the performance of their duties.

Performance evaluation The Board has established a formal process, led by the Chairman, for the annual evaluation of the performance of the Board, its principal Committees and individual Directors with particular attention to those who are due for reappointment. A list of questions is drawn up by the Chairman with the assistance of an independent consultant. These questions provide a framework for the evaluation process. The Chairman conducts the annual performance evaluation of each of the Directors, taking into account the views of the other Directors. The Senior Independent Director conducts the annual performance evaluation of the Chairman, taking into account the views of all Directors. The results of the overall evaluation process are discussed with the independent consultant, communicated to the Board and followed by appropriate action.

Re-election Subject to the Company's Articles of Association, the Companies Acts and satisfactory performance evaluation, non-executive Directors are appointed for an initial period of three years. Before the third or sixth anniversary of the non-executive Director's first appointment, the Director discusses with the Board whether it is appropriate for a further three year term to be served. The reappointment of Directors who have served for more than nine years is subject to annual review.

The Company's Articles of Association provide for:

- a) Directors to retire at the first Annual General Meeting ("AGM") after their appointment by the Board and for the number nearest to, but not exceeding, one-third of the remaining Directors to retire by rotation at each AGM;
- b) all Directors to retire at least every three years; and
- c) any Director aged 70 or over at the date of the AGM to retire.

Subject to the Articles of Association, retiring Directors are eligible for reappointment. In accordance with the Articles of Association, at the AGM to be held on 7 July 2004, Baroness Hogg, Dr J R Forrest and Mr B P Larcombe will retire by rotation and, being eligible, Baroness Hogg offers herself for reappointment.

Biographical details of the Directors are set out on pages 30 and 31 and the Board's recommendation for reappointment is set out in the Notice of the AGM.

Relations with shareholders The Board recognises the importance of maintaining a purposeful relationship with all its shareholders. The Chief Executive and the Finance Director, together with the Group Communications Director, meet with the Company's principal institutional shareholders to discuss relevant issues as they arise. The Chairman maintains a dialogue with shareholders on strategy, corporate governance and Directors' remuneration as required.

In addition to receiving regular reports from the Company's brokers, the brokers make presentations to the Board and have private discussions with the non-executive Directors. Non-executive Directors are invited to attend the Company's presentation to analysts and offered the opportunity to meet shareholders.

Constructive use of the AGM The Company uses its AGM as an opportunity to communicate with its shareholders. At the Meeting, business presentations are made by the Chief Executive and the Finance Director. The Chairmen of the Remuneration, Audit and Compliance and Nominations Committees are available to answer shareholders' questions.

The Notice of the AGM held on 9 July 2003 was dispatched to shareholders not less than 20 working days before the Meeting. At that Meeting, details of proxy votes received were made available and, in accordance with the recommendations of the new Combined Code, at the AGM to be held on 7 July 2004, details of the number of abstentions will also be made available. In accordance with the Company's Articles of Association, on a poll, every member who is present in person or by proxy has one vote for each share held.

Portfolio management and voting policy In relation to unquoted investments, the Group's approach is to seek to add value to the businesses in which the Group invests through the Group's extensive experience, resources and contacts. In relation to quoted investments, the Group's policy is to exercise voting rights on matters affecting the interests of the Group and its managed funds.

Employment The Group's policy is one of equal opportunity in the selection, training, career development and promotion of employees, regardless of gender, ethnic origin, religion and whether disabled or otherwise.

The Group treats applicants and employees with disabilities equally and fairly and provides facilities, equipment and training to assist disabled employees to do their jobs. Should an employee become disabled during their employment, efforts are made to retain them in their current employment or to explore the opportunities for their retraining or redeployment within the Group. The Group also provides financial support, through a Company Disability Scheme, to disabled employees who are unable to work.

The Group's principal means of keeping in touch with the views of its employees continue to be through employee appraisals, informal consultations, team briefings and staff surveys. Managers throughout the Group have a continuing responsibility to keep their staff fully informed of developments and to communicate financial results and other matters of interest. This is achieved by structured communication including regular meetings of employees.

The Group has clear grievance and disciplinary procedures in place, which include comprehensive procedures on discrimination and the Group's equal opportunities policy. The Group also has an employee assistance programme which provides a confidential, free and independent counselling service and is available to all staff and their families in the UK.

There are clearly defined staff policies for pay and working conditions. The Group's employment policies are designed to provide a competitive reward package which will attract and retain high quality staff, whilst ensuring that the cost element of these rewards remains at an appropriate level.

All UK employees receive a base salary and are eligible for a performance related bonus. The Group operates an Inland Revenue approved Share Incentive Plan to encourage employees' involvement in the performance of the Group and operates share plans for senior executives and investment staff. Further details of these plans are set out in the Remuneration report.

In its international operations, the Group's remuneration policy is influenced by market conditions and practices in the countries in which it operates. The overall remuneration package of employees in the Group's non-UK operations is similar in structure to that available to UK employees, except that employees outside the UK (other than expatriate UK employees) do not participate in the 3i Group Pension Plan. Instead they participate in local state or company pension schemes as appropriate to local market conditions. As at the most recent valuation date, 98% of UK employees were members of the 3i Group Pension Plan (details of which are set out in the Remuneration report).

Investment executives both in the UK and in the Group's non-UK operations may also participate in investment performance plans and carried interest schemes, which allow executives to share directly in the future profits on investments.

Charitable and political donations Charitable donations made by the Group in the year to 31 March 2004 amounted to £253,419. Excluding the Company's matching of Give As You Earn contributions by staff, approximately 29% of those charitable donations were to charities which advance education, approximately 50% went to causes which aim to relieve poverty or benefit the community, or both, and approximately 21% went to medical charities. Further details of charitable donations are set out in the Corporate responsibility report on pages 25 to 29.

In line with Group policy, no donations were made to political parties during the year. Under the Companies Act 1985, as amended, the Company is required to disclose particulars of any donation to any EU political organisation and EU political expenditure incurred during the year. During the period, 3i plc, the main trading company of the Group, made payments to three organisations, detailed below, which may fall within the definition of donations to EU political organisations. These payments (annual subscriptions to the Industry Forum of £2,938, the Enterprise Forum of £1,880 and the Federal Trust of £300) amounted to £5,118.

Policy for paying creditors The Group's policy is to pay creditors in accordance with the CBI Prompt Payers Code of Good Practice copies of which can be obtained from the Confederation of British Industry at Centre Point, 103 New Oxford Street, London WC1A 1DU. The Company had no trade creditors during the year. 3i plc had trade creditors outstanding at the year end representing 10 days of purchases.

Statement of Directors' responsibilities The Directors are required by UK company law to prepare accounts which give a true and fair view of the state of affairs of the Company and the Group as at the end of the period and of the profit for the period. The Directors have responsibility for ensuring that proper accounting records are kept which disclose with reasonable accuracy the financial position of the Group and enable them to ensure that the accounts comply with the Companies Act 1985. They have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities. Suitable accounting policies, which follow generally accepted accounting practice and are explained in the notes to the accounts, have been applied consistently and applicable accounting standards have been followed. In addition, reasonable and prudent judgments and estimates have been used in the preparation of the accounts.

Going concern The Directors are satisfied that the Company and the Group have adequate resources to continue to operate for the foreseeable future. For this reason, they continue to adopt the "going concern" basis for preparing the accounts.

Internal control The Board is responsible for the Group's system of internal control and reviews its effectiveness at least annually. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss.

Through the regular meetings of the Board and the schedule of matters reserved to the Board or its duly authorised Committees for decision, the Board aims to maintain full and effective control over appropriate strategic, financial, operational and compliance issues. The Board has put in place an organisational structure with clearly defined lines of responsibility and delegation of authority. Each year, the Board considers and approves a rolling strategic plan and an annual budget. In addition, there are established procedures and processes for planning and controlling expenditure and the making of investments. There are also information and reporting systems for monitoring the Group's businesses and their performance.

Risk Committee is a management committee formed by the Chief Executive whose purpose is to review the business of the Group in order to ensure that business risk is considered, assessed and managed as an integral part of the business. There is an ongoing process for identifying, evaluating and managing the Group's significant risks. This process was in place for the year ended 31 March 2004 and up to the date of this report. The process is regularly reviewed by the Board and complies with the internal control guidance for Directors on the Combined Code, issued by the Turnbull Committee. The process established for the Group includes:

Policies

- core values, Group standards and Group controls together comprising the Group's high level principles and controls, with which all staff are expected to comply;
- manuals of policies and procedures, applicable to all business units, with procedures for reporting weaknesses and for monitoring corrective action;
- a code of business conduct, with procedures for reporting compliance therewith;

Processes

- appointment of experienced and professional staff, both by recruitment and promotion, of the necessary calibre to fulfil their allotted responsibilities;
- a planning framework which incorporates a Board approved rolling strategic plan, with objectives for each business unit;
- formal business risk reviews performed by management which evaluate the potential financial impact and likelihood of identified risks and possible new risk areas, set control, mitigation and monitoring procedures and review actual occurrences identifying lessons to be learnt;
- a comprehensive system of financial reporting to the Board, based on an annual budget with monthly reports against actual results, analysis of variances, scrutiny of key performance indicators and regular re-forecasting;
- regular treasury reports to the Board, which analyse the funding requirements of each class of assets, track the generation and use of capital and the volume of liquidity, measure the Group's exposure to interest and exchange rate movements and record the level of compliance with the Group's funding objectives;
- a compliance department whose role is to integrate regulatory compliance procedures into the Group's systems;
- well defined procedures governing the appraisal and approval of investments including detailed investment and divestment approval procedures incorporating appropriate levels of authority and regular post investment reviews;

Verification

- an internal audit department which undertakes periodic examination of business units and processes and recommends improvements in controls to management;
- the external auditors who are engaged to express an opinion on the annual accounts;
- an Audit and Compliance Committee which considers significant control matters and receives reports from the internal and external auditors and the regulatory compliance function on a regular basis.

The internal control system is monitored and supported by an internal audit function which operates on an international basis and reports to management and the Audit and Compliance Committee on the Group's operations. The work of the internal auditors is focused on the areas of greatest risk to the Group determined on the basis of the Group's risk management process. The external auditors independently and objectively review the approach of management to reporting operating results and financial condition. In coordination with the internal auditors, they also review and test the system of internal financial control and the information contained in the Report and accounts to the extent necessary for expressing their opinion.

Auditors' independence and objectivity Subject to annual appointment by shareholders, auditor performance is monitored on an ongoing basis and formally reviewed every five years, the next review being scheduled for 2008. The Audit and Compliance Committee reviewed auditor performance during the year and concluded that Ernst & Young LLP's appointment as the Company's auditor should be continued.

The Committee recognises the importance of ensuring the independence and objectivity of the Company's auditors. It reviews the nature and extent of the services provided by them, the level of their fees and the element comprising non-audit fees. The Audit and Compliance Committee Chairman is notified of all assignments allocated to Ernst & Young over a set threshold, other than those related to due diligence within the Group's investment process where the team engaged would be independent of the audit team. Safeguards have been put in place to reduce the likelihood of compromising auditor independence, including the following principles which are applied in respect of services provided by the auditors and other accounting firms and monitored by the Audit and Compliance Committee:

- services required to be undertaken by the auditors, which include regulatory returns, formalities relating to borrowings, shareholder and other circulars. This work is normally allocated directly to the auditors;
- services which it is most efficient for the auditors to provide. In this case, information relating to the service is largely derived from the Company's audited financial records, for example, corporate tax services. This work is normally allocated to the auditors subject to consideration of any impact on their independence;
- services that could be provided by a number of firms including general consultancy work. All significant consultancy projects are normally put out to tender and work would be allocated to the auditors only if it did not present a potential threat to the independence of the audit team. Included in this category is due diligence work relating to the investment process. If this service were to be provided by the auditors, the specific team engaged would be independent of the audit team.

Details of the fees paid to the auditors are disclosed in note 14 to the accounts on page 57.

Ernst & Young LLP In accordance with section 384 of the Companies Act 1985, a resolution proposing the reappointment of Ernst & Young LLP as the Company's auditors will be put to members at the forthcoming Annual General Meeting.

By order of the Board

A W W Brierley
Secretary

12 May 2004

Registered Office
91 Waterloo Road
London SE1 8XP