CITY OF LONDON
INVESTMENT GROUP PLC

ANNUAL REPORT & ACCOUNTS
2006

Contents

Introduction and highlights

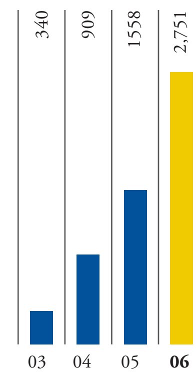
City of London Investment Group PLC is a leading emerging market and natural resource asset management group, specialising in the provision of products and services predominantly to institutional clients who include some of the US's leading blue chip institutions and endowment funds. City of London operates its business from offices in London, the US and Singapore.

- Admission to AIM on 12 April 2006 after placing 24.51% of the issued share capital in order to provide existing institutional shareholders with liquidity and the ability to realise part of their investment. These shares were placed with a deliberately small list of high quality institutions The Company raised no new money.
- Funds under management were US$2.8 billion at the year end (2005: US$1.6 billion) and the same at 31 August 2006.
- Profit before tax more than doubled to £4.8 million (2005: £2.1 million), reflecting the Group's growth in funds under management and the operational gearing inherent in the business.

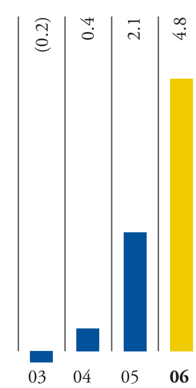
  The Board is not recommending a final dividend reflecting the fact that City of London was a publicly traded company for less than two months of the period. It is the Board's intention going forward to pay dividends to shareholders twice a year, an interim and a final, with the level of payout based on cover of two times.

"During the year under review, we were successful in winning new mandates but also further diversified our asset management product portfolio with the growth of our natural resources fund and the seeding of three new funds: a global emerging market fund, a frontier fund and an emerging markets yield fund. In addition, the Group commenced marketing its services and products in Europe. It is our strategic objective to globalise our business, building on the very strong base created in the North American market." **A Davison**, Chairman

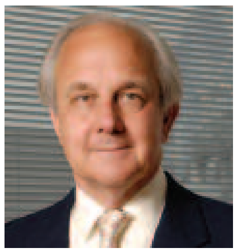
Funds under management US$m



Pre-tax profit £m



Chairman's statement



The year to 31st May 2006 was a successful one for City of London and I am pleased to be able to report substantial progress to both our long term and new shareholders.

Durable investment strategy suits volatile markets

Operating profit up 127%

Future dividend policy based on two times cover

AIM listing

Despite our achievements during the year under review, recent falls in emerging markets have inevitably overshadowed some of this success. However, the Board believes that our business model – based on tried and tested processes and an experienced management team – can cope with the volatility in our target investment markets. Emerging markets have always displayed volatility and it is our ability to outperform in all market conditions that has enabled the Group to consistently win investment mandates from sophisticated institutional investors. Our CEO, Barry Olliff, addresses operational issues, including investment markets, in his review which follows my statement.

Results

Funds under management during the period doubled to a peak in April 2006 of over US$3 billion before declining, with the markets, to US$2.8 billion at 31st May, a level which has since been maintained. Turnover from continuing activities during the year increased by 82% to £14.08 million (2005 – £7.74 million), producing a 127% rise in operating profits to £4.68 million (2005 – £2.06 million) as a result of the operational leverage in our activities whereby costs do not rise proportionally with turnover. Operating profit for the current year is stated net of £0.48 million costs related to the Admission to AIM. Discontinued activities represent the closure of a subsidiary and contributed just £38,700 of turnover and £9,357 of operating profit.

Profit before tax increased to £4.79 million (2005 – £2.12 million), a rise of 125%. The tax charge for the year was £1.78 million (2005 – £0.79 million) and dividends paid to shareholders pre-Admission to AIM were £2.28 million (2005 – £0.35 million). Retained profit for the year was £0.72 million (2005 – £0.98 million), which contributed to the significant increase in shareholders' funds to £4.33 million (2005 – £2.56 million). Cash balances at the year end were £2.71 million (2005 – £2.40 million). There were no borrowings. A more detailed explanation of the results is contained in the Financial review.

Dividends

The Board is not recommending a final dividend in respect of the financial year under review, reflecting the fact that City of London was a publicly traded company for less than two months of the period. The dividends paid to our pre-IPO shareholders in the period comprised an interim dividend of £1.98 million in respect of the year to 31st May 2006 and a final dividend of £0.30 million in respect of the year to 31st May 2005.

It is the Board's intention going forward to pay dividends to shareholders twice a year, an interim and a final, with the level of payout based on cover of two times – dividends will represent approximately half of post tax profits. We intend to declare or recommend dividends with the interim and full year results announced in January and September respectively followed by payments in February and November. The Board expects to declare a first dividend in respect of the current financial year with the interim results for the period to 30th November 2006 in January 2007.

Review

The major corporate event during the year was our Admission to AIM which took place at the very end of the period in April 2006. We sought a listing in order to provide our existing institutional shareholders with liquidity and the ability to realise their investments in the Group. At Admission, these shareholders sold shares representing approximately one quarter of the issued share capital and these shares were placed with a deliberately small list of high quality institutions. I welcome our new shareholders and thank the old ones for their support over a number of years. Those shareholders who sold shares at Admission agreed long term lock-in arrangements in respect of their remaining holding, and all directors and senior managers entered into similar lock-in agreements.

City of London's asset management activities are principally focused on providing emerging market products and services predominantly to institutional investor clients who include some of the United States' leading blue chip institutions and endowment funds. We manage Open Ended Funds as well as a number of segregated accounts from offices in London, the US and Singapore.

During the year under review, we were successful in winning new mandates but also further diversified our asset management product portfolio with the growth of our natural resources fund and the seeding of three new funds: a global emerging market fund, a frontier fund and an emerging markets yield fund. In addition, the Group commenced marketing its services and products in Europe. It is our strategic objective to globalise our business, building on the very strong base created in the North American market. Although we believe that there is scope for considerable growth in our activities in the United States in particular, we aim to diversify the client base to become a truly global business. To that end we are actively marketing our distinctive investment management services and pursuing opportunities in Europe and the Far East.

Directors, management and staff

I am delighted to welcome our new non-executive director, David Cardale, to the Board. David was appointed at the time of our Admission to AIM. David has spent his career in investment markets with significant experience in corporate finance and private equity in Europe and the United States. He is a co-founder and Chairman of Global Investor Relations, one of Europe's leading providers of online investor relations services.

Perhaps the principal benefit to the Company of the Admission to AIM is our increased ability to incentivise our staff and management through the use of option schemes. The Group has put in place schemes for staff in London, the US and Singapore as well as for senior management. Directors and employees now hold options to acquire a total of 4.75 million shares representing approximately 17.7% of the current issued share capital. Of the total shares under option, some 2.25 million shares (representing 8.4% of the issued share capital) are over shares held by an employee share trust and on exercise will therefore occasion no dilution. The Board believes that the recruitment, motivation and retention of talented people is vital to the success of the Group and that these schemes can give us a real advantage in so doing compared to non-listed rivals.

Outlook

Our expertise in emerging markets, natural resources and closed end funds in general is, we believe, exportable to a wider and more geographically diverse client base than that we currently serve. City of London has the people, systems and culture in place to enable this growth without the addition of significant extra costs. Despite the current volatility in emerging markets, we believe we are well placed to deliver further growth.

A Davison
Chairman
15th September 2006

Employee equity participation

Diversification and globalisation

A balanced Board: executive and non-executive

performance

Investment performance drives our business

Chief Executive Officer's review

This is our first Report and Accounts as a listed company and I would like to let you know that we value you as a shareholder in the City of London Investment Group. Over the years, we have developed close relationships with our clients and now that we have a number of new shareholders we would like to develop close relationships with you too.

I believe that one of the best ways of developing close relationships is by being as open as possible and I would hope that the information that you will find within this document is both interesting and useful. You will probably be well aware that part of our work revolves around closed end fund corporate governance, for this reason as well, we feel bound to lead by example regarding the quality of information disclosed to our shareholders.

The past financial year

This past financial year, like the preceding two, has allowed us to grow our business significantly. Funds under management ("FUM") increased from $1,558 million to $2,750 million or, measured in sterling, from £855 million to £1,471 million. However, we have recently experienced significant £/$ currency volatility. Most of our fees are paid in US dollars and are then repatriated back to the United Kingdom. Please refer to the Financial review on pages 8 to 9 for more details regarding our hedging strategy and a table showing the sensitivity of our income to moves in the $/£ exchange rate.

Over the past year there has been significant demand for our products, not just relating to emerging markets closed end funds, but also via equities providing natural resource exposure. By the end of 2005, we had closed all of our US-based emerging market commingled funds to new investors. This was principally because we were concerned regarding their size and in our ability, in the event that they grew significantly larger, to continue to outperform versus the various emerging market benchmarks via which we are measured. Separate from our emerging market commingled accounts, over the past year we have benefited from significant growth in the area of segregated accounts as well.

Diversification

But to return for a moment to our Natural Resources business, it is worth making the point that this part of our business has grown from $73 million at end May 2004 to $193 million as of end May 2006, which is the end of our financial year. As at the end of August, this figure has increased to $215 million, which was the end of our first quarter this new financial year.

This business, which is one of the areas of diversification that we have embarked upon, invests significantly in listed equities, rather than our traditional area of closed end funds. We are assuming, and planning, for this business to grow substantially over the next few years. As with our Closed End Fund business, we are positioned at the performance end of the marketplace which focuses on relative return products for institutional clients.

A possible new office

As a result of both the growth of the local stock markets in the Middle East, and the growth of interest in the region's emerging markets from the equity index providers, we are beginning to consider the possibility of opening an office within the Gulf Cooperation Council Region (GCC). The GCC, when combined with other countries within the Middle East, now represents in excess of 15% of the S&P/IFC Global Emerging Markets Index. As more securities from this region become investable and as new issuance continues to grow, it seems increasingly likely that we will need to research this area on a daily basis in a manner that could prove increasingly difficult from our offices in London or Singapore. As a result of our risk-averse approach to the development of our business, we would only undertake this type of expansion if we thought it would add significant value to our investment process. If we proceeded, we would

Natural resource accounts increase by 166%

Total funds under management grow by 77%

Growing significance of Middle East markets

Significant growth potential for funds under management and profit

Focus on holding down fixed overheads

additionally intend, over a period of time to use this office to market City of London products. As occurred in 1997 when we opened our US office, and again in 2000 when we opened our Singapore office, this office would be initially staffed by one or two existing City of London employees.

Business continuity plans

I thought it wise to relay some information regarding our Business Continuity Plans which would come into play in the event that we had, as a firm, to deal with some type of disaster scenario. First, we have the advantage of three diverse offices, with most key personnel having undertaken some form of training, typically for a few weeks, in at least two if not all three offices. On top of this, we have in place a contract with NDR Ltd, a leading UK provider of disaster recovery facilities, which could be called upon to replace any loss of operating capability, whether the result of something simple like a power cut or something more calamitous such as a flood or an explosion. This facility has been extensively tested, as have our daily back up routines, the source of full data and systems duplicates, which are stored off-site. On top of this, all key staff have remote internet access to the company's servers, whether in the UK, the US, or Singapore. Naturally, all of the above, plus additional detail, is described in our disaster recovery procedures, which are divided into two sections: technical and operational.

Cost income ratio

One of the ratios that is often cited within the investment management industry is the cost-income ratio, with the industry average being around 65%. City of London's cost-income ratio last year was 56% (after adjusting operating costs to strip out listing costs and third party marketing commission, which within this context is a reduction in fee income rather than a cost). A substantial part of our operating costs is represented by profit-share, as described in more detail in the Financial review, and the cost-income ratio adjusted to exclude these variable costs was 38%. In other words, the "fixed" overhead cost of supporting our FUM when measured as a percentage of net fee income, was 38%. The major components of our overheads are personnel, premises, IT and communications, and marketing and business development. We work hard to keep these items as low as possible whilst continuing to take a very long-term view regarding the development of our business.

Operational leverage

One of the advantages of maintaining a low ratio of costs to FUM is the extent to which Shareholders will benefit from the Operational Leverage within our business that can develop as a result of further growth in FUM.

Over the next year we will be focusing upon developing our business outside the US where around 85% of our assets are currently sourced. That is to say, that to the extent possible, we will be seeking additional assets to manage in the UK, Europe and the Far East.

Recently we seeded three new funds domiciled in the Cayman Islands, these three funds are Natural Resources, Emerging Markets and a Global Equity Fund. With minor variations these funds will be similar to existing City of London funds, they will however be marketed outside North America thus providing us with a new suite of Funds via which we would intend to develop our business over the next few years.

End of first quarter FUM

As of the end of August, total FUM was US$2,815 million. We are just over three months into the year and in the difficult markets that we have recently experienced I would like to point out that investment performance has been maintained.

Thanks to CoL employees

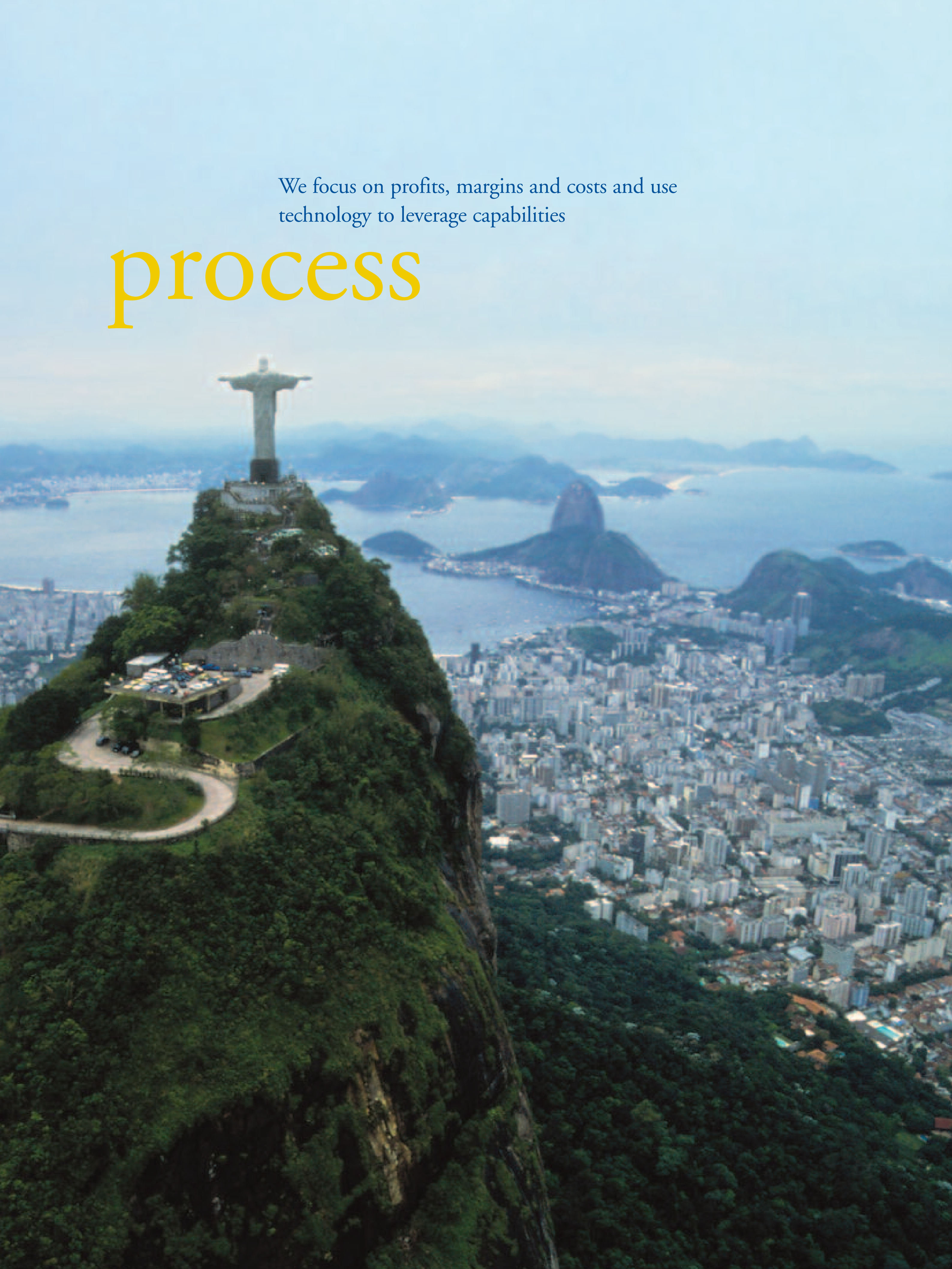
Finally, I would like to thank my colleagues for their hard work and continuing commitment in what has been a challenging year.

B M Olliff

B M Olliff
Chief Executive Officer
15th September 2006

We focus on profits, margins and costs and use technology to leverage capabilities

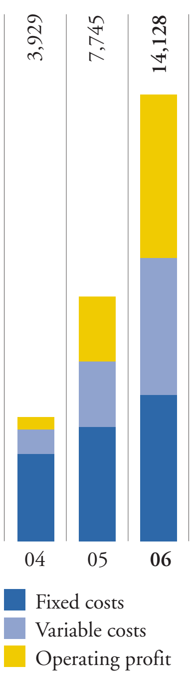
process



Financial review

Turnover, representing management fees charged as a percentage of funds under management, rose in line with the underlying increase in funds under management, and at £14.1million was almost double the previous year's figure.

Total income £k



Note: excludes AIM listing costs

The largest proportion of turnover, 93% (2005 – 78%), was derived from North America where the Group has increased funds under management significantly during the period. Fee margins were maintained, reflecting the Group's premium service positioning.

A substantial portion of Administrative Expenses is represented by costs that vary with turnover. This variable cost has two principal elements. First, commissions payable to marketing agents, principally in the US and generally fixed at 20% of fee income, amounted to £2.18 million for the year (2005 – £1.00 million). Second, it is the Group's policy to align staff costs with profitability by closely controlling our fixed salary overhead, and supplementing this with a profit-share scheme. Profit sharing accounted for £2.20 million (2005 – £0.94 million), representing 49% of total staff costs of £4.50 million (2005 – £2.93 million). The overall increase of 54% in staff costs therefore comprises a 134% increase in profit share but only a 16% increase in fixed overhead, which was largely accounted for by the increase in the average number of employees from 32 to 38 to accommodate the expansion of the business during the period.

Discontinued activities resulted from the closure of a subsidiary, City of London Quantitative Management Limited, in June 2005. This was, in turn, the result of the expiry of the sole management contract serviced by that subsidiary, which was in respect of a Chilean registered fund.

Dividends are reported in accordance with FRS 21, as a result of which the restated 2005 figure of £0.35 million comprises the final dividend for the year to 31st May 2004 and the interim dividend for the year to 31st May 2005, while the 2006 figure of £2.28 million comprises the final dividend for the year to 31st May 2005 and the interim dividends for the year to 31st May 2006.

The tax charge rate, at 37% of pre-tax profits (2005 – 37%), is higher than the 30% prevailing rate of UK corporation tax because that part of net income attributable to the US operations under the Group's transfer pricing policy attracts the higher US corporate tax rate, which - with federal and state taxes – is marginally in excess of 40%.

Recognised gains and losses

Recognised gains and losses include a revaluation reserve of £0.13 million (2005 – nil) which reflects the increase in the value of investments made by the Group in order to seed new funds. At 31st May 2006, these investments had a current market value of £1.36 million (2005 – £0.46 million), and the increase of £0.90 million during the year represents new investments of £0.77 million plus the revaluation reserve of £0.13 million. The prior year adjustment of £0.30 million (2005 – nil) is the final dividend for the year to 31st May 2005, restated as a result of the adoption of FRS 21, as described above.

Balance sheet

Net current assets make up 93% of total net assets (2005 – 91%). For the most part debtors and creditors convert to cash within a three month cycle, which is the longest fee billing period. Historically, there have been no overdue or bad debts, and the nature of our debtors – the funds we manage – is such that the risks of delay or default is low. Creditors comprise accruals of £1.07 million (2005 – £0.83 million), and tax of £0.78 million (2005 – £0.64 million). With regard to the latter, the increase over the prior year is relatively small because this year Corporation Tax has been paid in quarterly instalments in both the UK and the US (previously just the US). The other major component of creditors is third party marketing commission of £0.25 million (2005 – £0.12m).

The Company has extended loans amounting to £1.03 million (2005 – £1.26 million) to a trust set up for the purpose of acquiring and holding the Company's shares to service the Employee Share Option scheme. These loans are repaid on the exercise of options issued by the trust. The amount outstanding was reduced by £0.23 million during the year, following the exercise of options in respect of 513,300 shares. These options were all issued to staff between 1997 and 2001 at an exercise price of £0.45.

Share capital and the share premium account have increased by £0.03 million and £0.65 million respectively as a result of the exercise of 667,500 dilutive options issued to Barry Olliff in 1997 at £0.04, and 2,500,000 warrants issued to shareholders in 2004 at £0.26.

Currency exposure

The Group's income is substantially sourced in US$ (in the region of 90% of total income), while its expenses are roughly evenly divided between £ and US$ (with a small Singapore $ element). Consequently, net income as reported in £ is significantly exposed to movements in the $/£ exchange rate, which during the year to 31st May 2006 moved within the approximate range 1.70 to 1.90.

The following table illustrates the approximate effect across a range of funds under management assumptions, given the current geographical distribution of the expense base:

	Average FUM US$bn			
	2.5	3.0	3.5	4.0
US$/£	Pre-tax, £m			
1.80	6.2	8.7	11.2	13.7
1.85	5.9	8.4	10.8	13.2
1.90	5.7	8.1	10.4	12.8
1.95	5.5	7.8	10.1	12.4
2.00	5.3	7.5	9.8	12.0

Assumes:
1 Average net fee 0.9%.
2 Annual operating costs £3.0m plus US$6.0m.

A deeper analysis, however, would show that the Group's profitability is not as exposed as it might superficially appear to be, because the underlying dynamic offers a significant degree of natural hedge. This is so because the funds' underlying investments are substantially non-US$ denominated, and so a weaker US$ gives uplift to the US$ value of funds under management. Accordingly, the Group's hedging strategy is focused upon balance sheet exposure rather than revenue exposure, with forward sales of US$ being used when appropriate to substantially offset or eliminate the intrinsic long US$ position.

Accounting standards and policies

As an AIM listed company, City of London Investment Group is required to adopt International Financial Reporting Standards (IFRS) for the year ended 31st May 2008. The Board's current intention is to continue to produce accounts in line with UK GAAP until that time. The first results prepared under IFRS will therefore be the interim results for the six months to 30th November 2007.

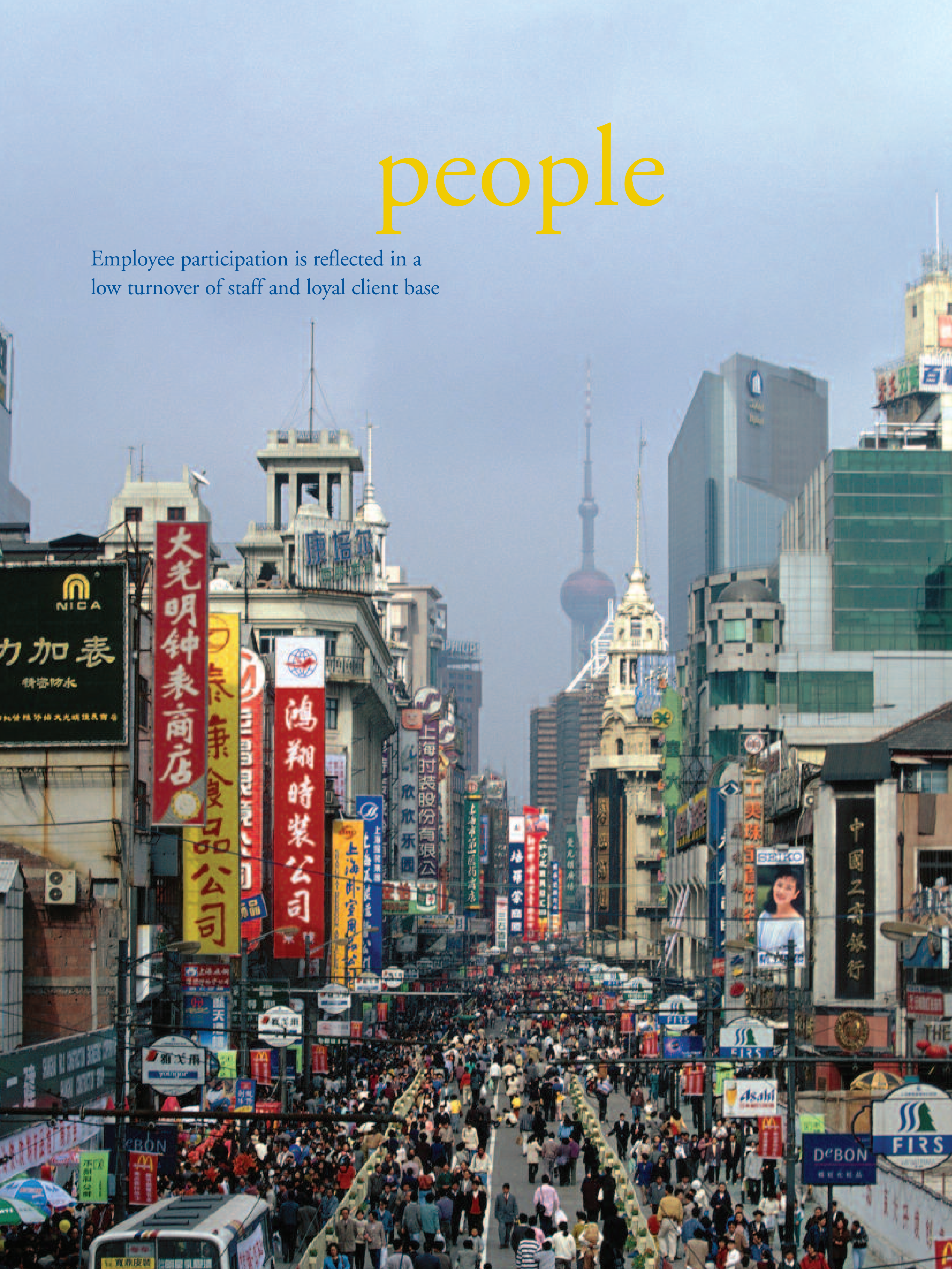
Dividends have been restated in accordance with FRS 21 as described above.

The Group's seed investments (as described above) have been included this year in current assets on the basis that they are available for immediate conversion to cash, and are not expected to be maintained in the long term. The comparative figures have been restated accordingly.

D F Allison
Finance Director
15th September 2006

people

Employee participation is reflected in a low turnover of staff and loyal client base



Officers and professional advisers

Directors

A Davison
(Chairman) (Non-executive)

D F Allison

O Ashur
(Non-executive)

D Cardale
(Non-executive)
(Appointed 10th March 2006)

T W Griffith

B M Olliff

G A Robb
(Non-executive)

C M Yuste
(Appointed 1st June 2005)

Company Secretary

D F Allison

Registered Office

10 Eastcheap
London
EC3M 1LX

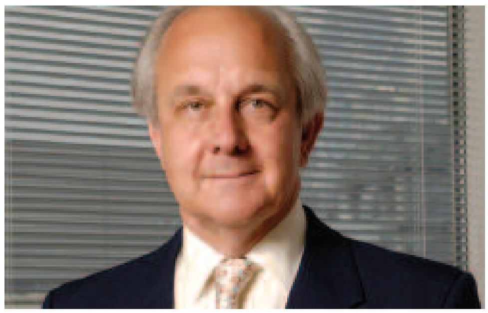
Bankers

The Royal Bank of Scotland plc
London City Office
62-63 Threadneedle Street
London
EC2R 8LA

Auditors

Moore Stephens LLP
Chartered Accountants
St. Paul's House
Warwick Lane
London
EC4M 7BP

Board of directors



A Davison

NON EXECUTIVE CHAIRMAN

Andrew Davison, a Chartered Accountant, joined County Bank Limited in 1972 and by 1984 had become Managing Director of NatWest Ventures. In 1987 he became Chairman and CEO of Business Mortgages Bank which was sold in 1991. He subsequently joined the Boards of a number of listed and unlisted companies.

B M Olliff

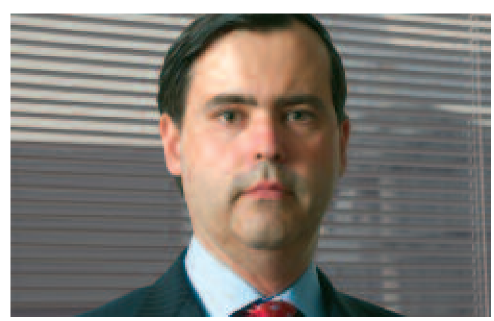
CHIEF EXECUTIVE OFFICER

Barry Olliff's career has spanned over 40 years within the investment trust (closed-end fund) sector. He began his career in 1964 with Denny Brothers, ultimately Pinchin Denny, as a market maker in the sector. In 1979 he moved to Laing & Cruickshank as a member of their investment trust department, and became a director in 1984. In 1987. He established Olliff & Partners, the stockbroker business from which City of London was founded in the early 1990's.

D F Allison

FINANCE DIRECTOR

Doug Allison qualified as a Chartered Accountant with Ernst & Young in 1980, and has worked in the financial services sector since 1984, joining City of London in 1997. He is also an Associate of the Chartered Institute of Bankers.



C M Yuste

BUSINESS DEVELOPMENT DIRECTOR

Carlos Yuste holds a BS in International Relations from the University of Ottawa, and an MA in International Political Economy from Carleton University, also in Ottawa. He worked at the International Development Research Centre in Ottawa from 1994 to 1998, leaving to undertake an International MBA at York University, Toronto, which he completed in 2000 before joining City of London in the same year.

T W Griffith

CHIEF OPERATING OFFICER

Prior to joining City of London Group in 2000, Thomas Griffith held various positions in the institutional client division of The Vanguard Group including roles as both a Client Relationship Manager and a Marketing Executive. In 1986 he obtained a bachelor's degree in Corporate Finance and Investment Management from the University of Alabama.

O Ashur

NON EXECUTIVE DIRECTOR

Omar Ashur is the chief financial officer of FMH, one of the Company's major shareholders and has an MBA and PhD from the Wharton School of the University of Pennsylvania, in Philadelphia.

D Cardale

NON EXECUTIVE DIRECTOR

David Cardale is the co-founder and Chairman of Global Investor Relations. He has worked extensively in both Corporate Finance and Private Equity. He has advised a number of fund management groups including Gartmore, Ivory & Sime and NIM, and ran the European operations of NatWest Equity Partners. He has been a director of two London listed Investment Trusts. David Cardale holds an MBA from INSEAD.

G A Robb

NON EXECUTIVE DIRECTOR

George Robb qualified as a solicitor before becoming fully involved with the asset management sector in 1971. He was a founder director and shareholder of Aberdeen Asset Management and in 1994 established AMIC. He is a non-executive director of several companies in which AMIC is invested.

Report of the directors

The directors present their annual report and the audited financial statements for the year ended 31st May 2006.

Principal activity and review of business

City of London Investment Group Plc is the holding company for a number of investment management subsidiaries. The principal operating subsidiary is City of London Investment Management Company Limited, which acts as an investment adviser and which advises on 22 accounts (2005 – 17 accounts) with a total of £1,471m (2005 – £783m) under management as at the end of the year. Two other operating subsidiaries, City of London Quantitative Management Limited and City of London Latin America Limited, ceased trading on 30th June 2005 and 31st January 2006 respectively, and in due course will be wound up.

The Report of the directors should be read in conjunction with the Chairman's statement, the Chief Executive Officer's review, and the Financial review on pages 2 to 9, which together provide a commentary on the operations of the Group.

Future prospects

The Board is optimistic as to the future and is committed to increasing the group's funds under management.

Results and dividend

The results of the group for the year, together with details of amounts transferred to reserves, are set out on page 20. The Company has paid dividends of £2,282,675 during the year (2005 – £350,009).

Corporate governance

(a) The Board of directors

The Board recognises the importance of good corporate practice and is committed to maintaining high standards of corporate governance throughout the group. The Board comprises four executive directors and four non-executive directors. The directors intend to comply with the Combined Code in such respects as are appropriate for a company of this size, nature and stage of development.

The Board meets regularly and has overall responsibility for ensuring that the group is properly led and controlled, and is accountable to shareholders for financial and operational performance. These responsibilities include the overall strategy of the group, approval of significant items of expenditure and consideration of significant financing matters pertaining to the group.

The Board has established an Audit Committee, a Remuneration Committee and a Nominations Committee (each comprising the four non-executive directors, who will invite other members of the Board to join meetings) with formally delegated duties and responsibilities.

(b) The Remuneration Committee

The Remuneration Committee is chaired by George Robb. It reviews the performance of executive directors and sets the scale and structure of their remuneration and reviews the basis of their service agreements with due regard to the interests of the shareholders. The Remuneration Committee also makes recommendations to the Board concerning the allocation of share options to directors and employees. The remuneration and terms of appointment of non-executive directors will be set by the Board.

The company has a remuneration policy, the aim of which is to provide, in the context of the group's business strategy, remuneration that will attract and retain high calibre executives and staff. In order to achieve this, total rewards are set at levels that are competitive within the relevant market. Rewards are earned through the achievement of objectives based on measures consistent with shareholder interests.

(c) The Audit Committee

The Audit Committee is chaired by Andrew Davison. It meets at least twice each year and is responsible for monitoring the quality of internal control, ensuring that the financial performance of the company is properly measured and reported on, meeting with the auditors and reviewing reports from the auditors relating to accounting and internal controls.

The finance director is invited to attend meetings but the committee meets with the auditors at least once a year without the finance director being present.

(d) The Nominations Committee

The Nominations Committee is chaired by Andrew Davison. It is responsible for reviewing and proposing appointments to the Board and the various Board committees. In addition, the committee has responsibility for reviewing the composition of the Board and for selecting candidates for appointment, to meet the desired composition.

(e) Corporate Governance in Investee Closed-End Funds

Since 1999, City of London has produced a detailed statement outlining the corporate governance procedures and policies it expects to be employed by closed-end funds in which we invest. We are now on the fifth edition of our "Statement on Corporate Governance and Voting Policy for Closed-End Funds". In publishing this statement we attempt to capture the current best practices in the corporate governance of closed-end funds.

Corporate governance is an integral part of our investment process because it is our firm belief that a closed-end fund with poor corporate governance will generally trade at a wide discount over time. Poor corporate governance in a closed-end fund results in fund price under-performance via the widening of the discount to the Net Asset Value at which the fund trades.

Our statement is addressed to Boards, Managers, Shareholders, and the Professional community. It attempts to define the responsibilities of all the parties involved within a closed-end fund, with the ultimate aim of promoting shareholder value and the long-term interests of the closed-end fund sector.

A copy of our statement is distributed to the members of the Boards of the closed-end funds in which we invest and is available on our website.

Directors interests and remuneration

(a) Shareholdings

The directors who served throughout the year and their interests in the company were as follows:

	Ordinary Shares of	
	1p each 2006	25p each 2005
A Davison *(Chairman) (non-executive)*	**49,000**	1,750
B M Olliff	**3,763,250**	104,733
D F Allison	**165,625**	380
T W Griffith	**14,075**	–
C M Yuste *(appointed 1st June 2005)*	**16,575**	–
G A Robb *(non-executive)*	–	–
O Ashur *(non-executive)*	–	–
C Arcella *(non-executive) (resigned 31st January 2006)*	–	–
D Cardale *(non-executive) (appointed 10th March 2006)*	–	–

Notes:

(i) By a special resolution of the company passed on 6th April 2006, each of the issued and unissued ordinary shares of 25p each was subdivided into 25 ordinary shares of 1p each.

(ii) On 4th July 2006 O Ashur purchased 5,000 shares, and T W Griffith purchased a further 2,500 shares, taking their holdings to 5,000 shares and 16,575 shares respectively.

Report of the directors

Continued

(b) Share options

At 31st May 2006 share options were held by the following directors:

	Number	Exercise price £	Date from which exercisable	Expiry date
B M Olliff	62,500	0.45	10th January 2004	10th January 2008
	62,500	0.45	13th September 2004	13th September 2008
	500,000	0.29	14th May 2007	14th May 2009
	25,000	1.40	31st March 2009	31st March 2016
D F Allison	62,500	0.45	10th January 2004	10th January 2008
	62,500	0.45	13th September 2004	13th September 2008
	250,000	0.26	14th May 2007	14th May 2014
	18,750	1.40	31st March 2009	31st March 2016
T W Griffith	50,000	0.45	10th January 2004	10th January 2008
	50,000	0.45	13th September 2004	13th September 2008
	250,000	0.26	14th May 2007	14th May 2014
	12,500	1.40	31st March 2009	31st March 2016
C M Yuste	50,000	0.45	10th January 2004	10th January 2008
	50,000	0.45	13th September 2004	13th September 2008
	250,000	0.26	14th May 2007	14th May 2014
	12,500	1.40	31st March 2009	31st March 2016

(c) Remuneration

The remuneration of the directors who held office during the year ended 31st May 2006 is set out below:

	Salary £	Profit share £	Health insurance £	**Total 2006 £**	Total 2005 £	**Pension 2006 £**	Pension 2005 £
Non-executive							
A Davison	25,764	–	–	**25,764**	21,250	–	–
G A Robb	15,764	–	–	**15,764**	9,750	–	–
O Ashur	15,764	–	–	**15,764**	12,750	–	–
D Cardale	4,483	–	–	**4,483**	–	–	–
	61,775	–	–	**61,775**	43,750	–	–
Executive							
B M Olliff	197,053	530,129	–	**727,182**	347,885	**24,632**	23,504
D F Allison	125,004	215,000	977	**340,981**	218,754	**15,626**	15,626
T W Griffith	85,858	126,677	–	**212,535**	126,583	**10,732**	9,150
C M Yuste	85,858	126,677	–	**212,535**	–*	**10,732**	–*
	493,773	998,483	977	**1,493,233**	693,222	**61,722**	48,280

*Carlos Yuste's appointment to the Board took effect from 1st June 2005.

Substantial shareholdings

At 29th August 2006, the Company had been notified of the following interests of 3% or more in the Company's ordinary shares:

Interested party	Number of shares	Percentage of issued shares
FMH Investments NV	7,929,425	29.61
B M Olliff	3,763,250	14.05
Scaleoption plc	3,134,300	11.70
Asset Management Investment Company PLC	2,531,275	9.45
F&C Asset Management	2,517,510	9.40
The City of London Employee Share Option Trust	2,455,250	9.17

Creditor payment policy

The Company's current policy concerning the payment of its trade creditors is to:

(a) settle the terms of payment with suppliers when agreeing the terms of each transaction;

(b) ensure that suppliers are made aware of the terms of payment; and

(c) abide by the terms of payment.

The payment policy applies to all payments to suppliers for revenue and capital supplies of goods and services without exception.

As at 31st May 2006, the creditor days are Nil (2005 – Nil).

Donations

During the year the group made charitable donations of £2,000.

Auditors

On 3rd October 2005, Moore Stephens, the Company's auditor, transferred its entire business to Moore Stephens LLP, a limited liability partnership incorporated under the Limited Liability Partnerships Act 2000. The directors consented to treating the appointment of Moore Stephens as extending to Moore Stephens LLP with effect from 3rd October 2005. A resolution to re-appoint Moore Stephens LLP as the Company's auditor will be put to the forthcoming Annual General Meeting.

Each of the persons who are directors at the time when this report is approved has confirmed that:

(a) so far as each director is aware, there is no relevant audit information of which the company's auditors are unaware; and

(b) each director has taken all the steps that ought to have been taken as a director, including making appropriate enquiries of fellow directors and the company's auditors for that purpose, in order to be aware of any information needed by the company's auditors in connection with preparing their report and to establish that the company's auditors are aware of that information.

Approved by the Board of directors and signed on behalf of the Board

D F Allison
Company Secretary
15th September 2006

Statement of directors' responsibilities

United Kingdom 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 the group as at the end of the financial year and of the profit or loss of the group for that year. 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;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for the system of internal control, for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors' report to the shareholders of City of London Investment Group plc

We have audited the group and parent company financial statements (the "financial statements") of City of London Investment Group plc for the year ended 31st May 2006 which are set out on pages 20 to 36. These financial statements have been prepared under the accounting policies set out therein.

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 auditors' 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' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of directors' responsibilities.

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 Act 1985. We also report to you if, in our opinion, 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 other transactions is not disclosed.

We report to you whether in our opinion the information given in the directors' report is consistent with the financial statements. In addition, we read other information contained in the Annual Report. This other information comprises the Introduction and highlights, the Chairman's statement, the Chief Executive Officer's review and the Financial review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

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 judgments 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 United Kingdom Generally Accepted Accounting Practice, of the state of the group's and the parent company's affairs as at 31st May 2006 and of the group's profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

Moore Stephens LLP
15th September 2006
Registered Auditors and Chartered Accountants
St Paul's House, Warwick Lane, London EC4M 7BP

Consolidated profit and loss account

For the year ended 31st May 2006

	Note	Discontinued 2006 £	Continuing 2006 £	Total 2006 £	Total 2005 (as restated) £
Turnover	1,2	38,700	14,079,939	**14,118,639**	7,744,770
Administrative expenses					
Staff costs	4(b)	16,455	4,488,282	**4,504,737**	2,934,801
Other administrative expenses		21,264	4,329,643	**4,350,907**	2,651,112
AIM listing costs		–	482,708	**482,708**	–
Depreciation		35	108,077	**108,112**	98,541
		(37,754)	(9,408,710)	**(9,446,464)**	(5,684,454)
Other operating income		8,411	1,109	**9,520**	–
Operating profit	6	9,357	4,672,338	**4,681,695**	2,060,316
Interest receivable and similar income	7			**109,562**	64,065
Profit on ordinary activities before taxation				**4,791,257**	2,124,381
Tax charge on profit on ordinary activities	8			**(1,784,138)**	(790,890)
Profit on ordinary activities after taxation				**3,007,119**	1,333,491
Dividends	9			**(2,282,675)**	(350,009)
Retained profit for the financial year	17			**724,444**	983,482
Basic profit per share	10			**13.8p**	6.4p
Diluted profit per share	10			**11.9p**	4.8p

Consolidated statement of total recognised gains and losses

For the year ended 31st May 2006

	Note	2006 £	2005 (as restated) £
Retained profit for the period		**724,444**	983,482
Increase in revaluation reserve		**134,506**	–
Total recognised gains and losses for the period		**858,950**	983,482
Prior year adjustment	17	**300,013**	
Total gains and losses recognised since the last annual report		**1,158,963**	

Consolidated balance sheet

31st May 2006

	Note	2006 £	2005 (as restated) £
Fixed assets			
Tangible assets	11	225,939	201,993
Investments	12	61,253	20,028
		287,192	222,021
Current assets			
Debtors	13	2,136,312	1,092,529
Investments	14	1,359,563	463,890
Cash at bank and in hand		2,708,915	2,398,040
		6,204,790	3,954,459
Creditors, amounts falling due within one year	15	(2,160,169)	(1,611,302)
Net current assets		4,044,621	2,343,157
Total assets less current liabilities		4,331,813	2,565,178
Capital and reserves			
Called up share capital	16	267,777	236,102
Share premium account	17	1,357,283	712,258
Investment in own shares	17	(1,027,283)	(1,258,268)
Revaluation reserve	17	134,506	–
Profit and loss account	17	3,599,530	2,875,086
Shareholders' funds	17	4,331,813	2,565,178

The Board of directors approved these financial statements on 15th September 2006.

Signed on behalf of the Board of directors

B M Olliff
Chief Executive Officer

D F Allison
Finance Director

Company balance sheet

31st May 2006

	Note	2006 £	2005 (as restated) £
Fixed assets			
Tangible assets	11	63,252	68,960
Investments	12	636,187	372,030
		699,439	440,990
Current assets			
Debtors	13	632,617	507,065
Investments	14	1,359,563	463,890
Cash at bank and in hand		35,261	354,192
		2,027,441	1,325,147
Creditors, amounts falling due within one year	15	(1,093,182)	(920,616)
Net current assets		934,259	404,531
Total assets less current liabilities		1,633,698	845,521
Capital and reserves			
Called up share capital	16	267,777	236,102
Share premium account	17	1,357,283	712,258
Investment in own shares	17	(1,027,283)	(1,258,268)
Revaluation reserve	17	134,506	–
Profit and loss account	17	901,415	1,155,429
Shareholders' funds	17	1,633,698	845,521

The Board of directors approved these financial statements on 15th September 2006.

Signed on behalf of the Board of directors

B M Olliff
Chief Executive Officer

D F Allison
Finance Director

Cash flow statement

For the year ended 31st May 2006

	Note	2006 £	2005 £
Consolidated cash flow statement			
Net cash inflow from operating activities	20	4,145,424	2,199,337
Returns on investments and servicing of finance	21	109,562	64,065
Taxation	21	(1,643,687)	(223,889)
Capital expenditure and financial investment	21	(164,267)	(222,509)
Equity dividends paid		(2,282,675)	(350,009)
Financing	21	907,685	–
Management of liquid resources	21	(761,167)	(311,027)
Increase in cash	23	310,875	1,155,968

Notes to the financial statements

For the year ended 31st May 2006

1 Accounting policies

The financial statements are prepared in accordance with applicable United Kingdom law and accounting standards. The principal accounting policies adopted by the directors are set out below.

(a) Consolidation

These financial statements consolidate the financial statements of the company and all of its subsidiary undertakings. The company's principal subsidiaries are City of London Investment Management Company Limited and City of London US Services Limited, all other subsidiaries being dormant at 31st May 2006

Goodwill of £25,023 arising on the acquisition of the subsidiary undertakings, being the excess of cost over the fair value of the net tangible assets acquired, was written off directly to reserves in the year of acquisition for those acquisitions prior to 23rd December 1998. Any goodwill arising on subsequent acquisitions will be capitalised and amortised over its useful economic life.

(b) Turnover

Turnover arises in Europe, North America and South America and comprises investment management fees earned.

(c) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date and any exchange differences arising are dealt with through the profit and loss account.

(d) Tangible fixed assets and depreciation

For all tangible fixed assets depreciation is calculated to write off their cost to their estimated residual values by equal annual instalments over the period of their estimated useful lives, which are considered to be:

Short leasehold property improvements	–	over the remaining life of the lease
Furniture and equipment	–	four years
Computer and telephone equipment	–	four years

(e) Investments

Fixed asset investments are stated at cost less provision for any impairment in value.

Current asset investments are those investments which are considered to be liquid assets. They are stated at market value, and unrealised gains and losses are reflected in the revaluation reserve in accordance with the alternative accounting rules of the Companies Act 1985. Comparatives have been restated in order to facilitate comparison with the current period.

(f) Leases

The cost of operating leases is charged to the profit and loss account in equal periodic instalments over the periods of the leases.

(g) Pensions

The group operates defined contribution pension schemes covering the majority of its employees. The costs of the pension schemes are charged to the profit and loss account as they accrue.

1 Accounting policies continued

(h) Comparatives

Comparatives have been restated in respect of the presentation of dividends in accordance with FRS 21.

(i) Deferred taxation

Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates that are expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements. Deferred tax assets are recognised to the extent that it is regarded more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

2 Turnover

	2006 £	2005 £
Management fees earned by subsidiary companies charged as a percentage of funds under management	14,118,639	7,744,770

3 Analysis of turnover, operating profit and net assets

The directors consider that the group only undertakes one class of business, and hence only analysis by geographical location is given.

	Turnover		Operating profit		Net assets	
	2006 £	2005 £	2006 £	2005 £	2006 £	2005 (as restated) £
Europe	585,206	360,512	919,223	97,514	2,271,782	2,670,533
North America	13,185,903	6,093,723	3,538,613	1,203,505	2,014,559	31,082
South America	298,173	1,290,535	205,660	759,297	5,084	(136,437)
Other	49,357	–	18,199	–	40,388	–
	14,118,639	7,744,770	4,681,695	2,060,316	4,331,813	2,565,178

Notes to the financial statements

Continued

4 Employees

(a) Average number of persons employed by the group in the year:

	2006 Number	2005 Number
Investment management staff	9	6
Sales and dealing staff	2	1
Research staff	7	6
Settlement staff	2	2
Administration staff	18	17
	38	32

(b) Staff costs incurred during the year in respect of these employees were:

	2006 £	2005 £
Wages and salaries	1,960,784	1,589,449
Profit sharing payments	2,024,485	940,574
Social security costs	299,276	220,834
Defined contribution pension costs	220,192	183,944
	4,504,737	2,934,801

The group made contributions of £220,192 (2005 – £183,944) in the period to individual defined contribution pension schemes established for directors and employees. There were no outstanding or prepaid contributions at the balance sheet date.

5 Directors

Directors' emoluments comprise:

	2006 £	2005 £
Emoluments (excluding pension contributions and awards under share option schemes)	1,555,008	773,604
Pension contributions	61,722	52,699

	2006 Number	2005 Number
Number of directors on whose behalf pension contributions were paid during the year	4	4

	2006 £	2005 £
Number of directors who exercised share options during the period	2	–
Highest paid director's remuneration: Emoluments (excluding pension contributions and awards under share option schemes and other long-term incentive schemes)	727,181	347,885
Pension contributions	24,632	23,504

The highest paid director exercised share options during the period.

6 Operating profit

	2006 £	2005 £
The operating profit is arrived at after charging:		
Depreciation of owned assets	**108,112**	98,541
Auditors' remuneration:		
– Audit fees	**53,450**	30,000
– Other services	**131,142**	27,306
Operating lease rentals:		
– Land and buildings	**143,516**	96,875

7 Interest receivable and similar income

	2006 £	2005 £
Interest on bank deposit	**109,562**	64,065

8 Tax charge on profit on ordinary activities

(a) Analysis of tax charge on ordinary activities:

	2006 £	2005 £
Tax at 30% (2005 – 30%) based on the profit for the year	**1,538,223**	628,628
Double taxation relief	**(415,360)**	(331,628)
Adjustments in respect of prior years	**(3,148)**	(7,995)
	1,119,715	289,005
Foreign tax for the current period	**652,983**	503,000
Adjustments in respect of prior years	**11,440**	(1,115)
	664,423	501,885
	1,784,138	790,890

Notes to the financial statements

Continued

8 Tax charge on profit on ordinary activities continued

(b) Factors affecting tax charge for the current period:

The tax assessed for the period is different to that resulting from applying the standard rate of corporation tax in the UK: 30% (prior year: 30%). The differences are explained below:

	2006 £	2005 £
Profit on ordinary activities before tax	4,791,257	2,124,381
Tax at 30% thereon	(1,437,377)	(637,314)
Effects of:		
Expenses not deductible for tax purposes	(100,000)	(2,968)
Capital allowances more than depreciation	–	9,202
Unrelieved overseas tax	(237,623)	(171,372)
Prior period adjustments	(8,292)	9,110
Other	(846)	2,452
	(1,784,138)	(790,890)

9 Dividend

	2006 £	2005 (as restated) £
Dividends paid:		
Interim dividend of £2.15 per share (2005 – £0.24)	1,982,662	200,009
Final dividend in respect of year ended:		
31st May 2004 of £0.18 per share	–	150,000
31st May 2005 of £0.36 per share	300,013	–
	2,282,675	350,009

10 Earnings per share

The calculation of basic earnings per share is based on the profit for the year of £3,007,119 (2005 – £1,333,491) divided by the weighted average of ordinary shares in issue for the year ended 31st May 2006 of 21,855,212 (2005 – 20,834,250).

As set out in Note 17 the Employee Benefit Trust held ordinary shares in the Company as at 31st May 2006. The Trustees of the Trust have waived all rights to dividends associated with these shares. In accordance with FRS22 the ordinary shares held by the Employee Benefit Trust have been excluded from the calculation of the weighted average of ordinary shares in issue.

The calculation of diluted earnings per share is based on the profit for the year of £3,007,119 (2005 – £1,333,491) divided by the diluted weighted average of ordinary shares for the year ended 31st May 2006 of 25,272,459 (2005 – 27,587,026).

FRS22 requires that diluted earnings per share is calculated using the average share price during the year. The company listed on AIM during the year, and so the average share price since that time has been used in the above calculation.

Comparative figures for ordinary shares anticipate the 25:1 share split to facilitate comparison with the current year.

11 Tangible fixed assets

Group

	Furniture and Equipment £	Computer and Telephone Equipment £	Short Leasehold Improvements £	Total £
Cost				
At 1st June 2005	82,548	552,863	157,448	792,859
Additions	12,595	118,958	1,715	133,268
Disposals	(446)	(84,241)	–	(84,687)
At 31st May 2006	94,697	587,580	159,163	841,440
Accumulated depreciation				
At 1st June 2005	77,511	372,793	140,562	590,866
Charge for the year	4,828	96,632	6,652	108,112
Disposals	(446)	(83,031)	–	(83,477)
At 31st May 2006	81,893	386,394	147,214	615,501
Net book value				
At 31st May 2006	12,804	201,186	11,949	225,939
At 31st May 2005	5,037	180,070	16,886	201,993

Company

	Furniture and Equipment £	Computer and Telephone Equipment £	Short Leasehold Improvements £	Total £
Cost				
At 1st June 2005	44,437	235,304	132,419	412,160
Additions	2,687	30,309	–	32,996
Disposals	(446)	(57,635)	–	(58,081)
At 31st May 2006	46,678	207,978	132,419	387,075
Accumulated depreciation				
At 1st June 2005	42,632	181,296	119,272	343,200
Charge for the year	1,273	32,126	5,305	38,704
Disposal	(446)	(57,635)	–	(58,081)
At 31st May 2006	43,459	155,787	124,577	323,823
Net book value				
At 31st May 2006	3,219	52,191	7,842	63,252
At 31st May 2005	1,805	54,008	13,147	68,960

Notes to the financial statements

Continued

12 Investments held as fixed assets

Group

	Unlisted Investments £
Cost	
At 1st June 2005 – as restated	20,028
Exchange translation	(502)
Additions	41,727
At 31st May 2006	61,253

Company

	Unlisted investments £	Shares in subsidiary undertakings £	Total £
Cost			
At 1st June 2005 – as restated	20,028	352,002	372,030
Exchange translation	(502)	–	(502)
Additions	40,657	234,000	274,657
Disposals	–	(9,998)	(9,998)
At 31st May 2006	60,183	576,004	636,187

Subsidiary undertakings	Activity	Holding of ordinary shares
City of London Investment Management Company Limited	Management of funds	100%
City of London Unit Trust Managers Limited	Dormant company	100%
Grange Nominees Limited	Nominee company	100%
Olliff & Partners Incorporated Limited	Dormant company	100%
City of London US Investments Limited	Holding company for US companies	100%

City of London US Investments Limited holds 100% of the ordinary shares in the following:

City of London US Services Limited	Service company
City of London Quantitative Management Limited	Management of funds
City of London Latin America Limited	Management of funds

The above companies are incorporated in Great Britain and registered in England and Wales. They are included in the consolidated financial statements of the group. In the opinion of the directors, the value of the subsidiaries is at least equal to their cost.

13 Debtors

	Group		Company	
	2006 £	2005 £	2006 £	2005 (as restated) £
Trade debtors	1,762,550	960,851	–	–
Amounts owed by group undertakings	–	–	35,110	431,843
Other debtors	180,282	42,754	98,779	27,189
Prepayments and accrued income	193,480	80,947	157,725	48,033
Corporation tax recoverable	–	7,977	341,003	–
	2,136,312	1,092,529	632,617	507,065

14 Current asset investments

Group and Company

	31st May 2006 £	31st May 2005 (as restated) £
Unlisted investments at market value	1,359,563	463,890
Unlisted investments at cost	1,225,057	463,890

15 Creditors: amounts falling due within one year

	Group		Company	
	2006 £	2005 (as restated) £	2006 £	2005 (as restated) £
Trade creditors	252,893	122,098	–	–
Sundry creditors	57,279	19,244	85,357	1,011
Amounts owed to group undertakings	–	–	541,520	463,422
Other creditors including taxation and social security	780,692	640,242	–	42,351
Accruals and deferred income	1,069,305	829,718	466,305	413,832
	2,160,169	1,611,302	1,093,182	920,616

Notes to the financial statements

Continued

16 Share capital

Group and Company

	31st May 2006 Number of shares	31st May 2005 Number of shares
Authorised		
Ordinary shares of 1p (2005 – 25p each)	**90,000,000**	1,200,000
	£	£
Ordinary shares of 1p (2005 – 25p each)	**900,000**	300,000

Group and Company

	31st May 2006 Number of shares	31st May 2005 Number of shares
Allotted, called up and fully paid		
Ordinary shares of 1p each (2005 – 25p each)	**26,777,800**	944,412
	£	£
Ordinary shares of 1p each (2005 – 25p each)	**267,777**	236,102

During the period, the company allotted 126,700 £0.25 ordinary shares of which 100,000 were at a premium of £6.25 per share and 20,700 at a premium of £0.75 per share.

During the period, the company passed a special resolution thus sub-dividing each of its issued and unissued £0.25 shares into 25 £0.01 shares. This resulted in the company's issued share capital of £1,071,112 £0.25 ordinary shares becoming 26,777,800 £0.01 ordinary shares and its authorised share capital of 1,200,000 £0.25 ordinary shares becoming 30,000,000 £0.01 ordinary shares. On the same day the company also passed a special resolution to increase its authorised share capital to 90,000,000 ordinary shares of £0.01 each.

17 Combined statement of movement in reserves and reconciliation of shareholders' funds

Group

	Share capital £	Share premium account £	Investment in own shares £	Revaluation reserve £	Profit and loss account £	Total £	Year ended 31st May 2005 Total (as restated) £
At 1st June 2005 – as previously stated	236,102	712,258	(1,258,268)	–	2,575,073	2,265,165	1,431,696
Prior year adjustment FRS 21	–	–	–	–	300,013	300,013	150,000
At 1st June 2005 – as restated	236,102	712,258	(1,258,268)	–	2,875,086	2,565,178	1,581,696
Revaluation reserve	–	–	–	134,506	–	134,506	–
Share allotment	31,675	645,025	230,985	–	–	907,685	–
Profit retained for the period	–	–	–	–	724,444	724,444	983,482
At 31st May 2006	**267,777**	**1,357,283**	**(1,027,283)**	**134,506**	**3,599,530**	**4,331,813**	**2,565,178**

Company

	Share capital £	Share premium account £	Investment in own shares £	Revaluation reserve £	Profit and loss account £	Total £	Year ended 31st May 2005 Total (as restated) £
At 1st June 2005 – as previously restated	236,102	712,258	(1,258,268)	–	1,205,416	895,508	744,624
Prior year adjustment FRS 21	–	–	–	–	(49,987)	(49,987)	(50,000)
At 1st June 2005 – as restated	236,102	712,258	(1,258,268)	–	1,155,429	845,521	694,624
Revaluation reserve	–	–	–	134,506	–	134,506	–
Share allotment	31,675	645,025	230,985	–	–	907,685	–
(Loss)/profit retained for the period	–	–	–	–	(254,014)	(254,014)	150,897
At 31st May 2006	**267,777**	**1,357,283**	**(1,027,283)**	**134,506**	**901,415**	**1,633,698**	**845,521**

Investments in own shares relate to City of London Investments Group Plc shares held by an Employee Benefit Trust on behalf of City of London Investment Group Plc.

At 31st May 2006 the Trust held 2,262,750 ordinary 1p shares (2005 – 111,042 ordinary 25p shares), of which 2,247,050 ordinary 1p shares (2005 – 102,748 ordinary 25p shares) were subject to options in issue.

In total, the company has granted options over 4,747,050 ordinary shares at exercise prices from £0.26 to £1.40. These options have a range of exercise dates from September 2000 to March 2016.

Notes to the financial statements

Continued

18 Profit of the Parent Company

As permitted by section 230 of the Companies Act 1985, the profit and loss account of the parent company is not presented as part of these financial statements. The parent company's profit for the financial period before dividends paid, amounted to £2,028,661 (2005 restated – £500,906).

19 Operating lease commitments

At 31st May 2006 the group was committed to making the following payments during the next year in respect of operating leases:

	Motor vehicle 2006 £	Land and buildings 2006 £	Motor vehicle 2005 £	Land and buildings 2005 £
Leases which expire:				
Within one year	–	34,755	–	10,052
In the second to fifth years inclusive	6,826	99,496	–	82,447
	6,826	134,251	–	92,499

20 Reconciliation of operating profit to net cash inflow from operating activities

	2006 £	2005 (as restated) £
Operating profit	4,681,695	2,060,316
Profit on sale of fixed assets	(9,519)	–
Depreciation charges	108,112	98,541
Decrease in debtors	(1,043,783)	(468,946)
Increase in creditors	408,417	509,527
Translation adjustments on investments	502	(101)
Net cash inflow from operating activities	4,145,424	2,199,337

21 Gross cash flows

	2006 £	2005 £
Returns on investments and servicing of finance		
Interest received	109,562	64,065
Taxation		
Corporation tax paid	(1,643,687)	(223,889)
Capital expenditure and financial investment		
Payments to acquire investments	(41,727)	–
Payments to acquire tangible fixed assets	(133,268)	(222,509)
Receipts from sales of tangible fixed assets	10,728	–
	(164,267)	(222,509)
Financing		
Repayment of ESOP loan	230,985	–
Issue of ordinary share capital	676,700	–
	907,685	–
Management of liquid resources		
Payment to acquire current asset investments	(761,167)	(463,890)
Receipts from sale of current asset investments	–	152,863
	(761,167)	(311,027)

22 Reconciliation of net cash flow to movement in net funds

	2006 £	2005 (as restated) £
Increase in cash in the year	310,875	1,155,968
Increase in liquid assets	761,167	311,027
Non cash changes	134,506	–
Change in net funds	1,206,548	1,466,995
Net funds at 1st June	2,861,930	1,394,935
Net funds at 31st May	4,068,478	2,861,930

Notes to the financial statements

Continued

23 Analysis of changes in net funds

	At 1st June 2005 £	Cash flows £	Revaluation reserve £	At 31st May 2006 £
Cash at bank and in hand	2,398,040	310,875	–	**2,708,915**
Current asset investments	463,890	761,167	134,506	**1,359,563**
	2,861,930	1,072,042	134,506	**4,068,478**

24 Related party transactions

Advantage has been taken of the exemption under Financial Reporting Standard No. 8 not to disclose transactions between entities, 90% or more of whose voting rights are controlled within the Group.

There are no other related party transactions requiring disclosure.

25 Financial instruments

Most of the group's revenues, and a significant part of its expenses, are denominated in currencies other than sterling, principally United States' and Canadian Dollars. These revenues are derived from fee income which is based upon the net asset value of accounts managed, and have the benefit of a natural hedge by reference to the underlying currencies in which investments are held. Inevitably, debtor and creditor balances arise which in turn give rise to currency exposure. Each of the group's subsidiaries eliminates its currency exposure by transfer to the holding company. All hedging activity is therefore assessed at the group level. Forward foreign exchange transactions are executed so as to substantially reduce the group's exposure to currency market movements. The level of forward currency hedging is such as is judged by the directors to be consistent with market conditions.

As at 31st May 2006, the group had net asset balances of US $7,507,086, offset by forward sales totalling US $3,600,000, and net asset balances of C $501,335.

The group has no borrowings, and therefore has no exposure to interest rate risk other than that which attaches to its interest earning cash balances. The group's strategy is to maximise the amount of cash which is maintained in interest bearing accounts, and to ensure that those accounts attract a competitive interest rate. At 31st May 2006 the group held £2,708,915 in cash balances, of which £2,552,656 was held in bank accounts which attract variable interest rates.

The fair value of the group's financial assets and liabilities is materially the same as the book value.

Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting of City of London Investment Group Plc will be held at the offices of Tavistock Communications, 131 Finsbury Pavement, London EC2A 1NT on Monday 30th October 2006 at 11.30 am for the following purposes:

Ordinary business

1. To receive and adopt the financial statements for the year ended 31 May 2006 together with the reports of the directors and auditors thereon.

2. Having retired by rotation, to re-elect Barry Martin Olliff as a director of the Company in accordance with article 132 of the Company's articles of association.

3. Having retired by rotation, to re-elect Douglas Forbes Allison as a director of the Company in accordance with article 132 of the Company's articles of association.

4. Having retired by rotation, to re-elect Andrew John Davison as a director of the Company in accordance with article 132 of the Company's articles of association.

5. Having retired by rotation, to re-elect Omar Issam Ashur as a director of the Company in accordance with article 132 of the Company's articles of association.

6. Having been appointed by the board since the last annual general meeting, to re-elect George Alan Robb as a director of the Company in accordance with article 136 of the Company's articles of association.

7. Having been appointed by the board since the last annual general meeting, to re-elect Carlos Manuel Yuste as a director of the Company in accordance with article 136 of the Company's articles of association.

8. Having been appointed by the board since the last annual general meeting, to re-elect David Cardale as a director of the Company in accordance with article 136 of the Company's articles of association.

9. To re-appoint Moore Stephens LLP as auditors of the Company to hold office from the conclusion of the meeting until the conclusion of the next general meeting of the Company at which accounts are laid before the Company and authorise the directors to determine the auditors' remuneration.

Special business

To consider and, if thought fit, pass the following resolution as a special resolution:

10. THAT the Company be generally and unconditionally authorised to make market purchases (within the meaning of section 163(3) of Act) of any of its ordinary shares of £0.01 (1p) provided that:

    (a) the maximum number of ordinary shares which may be purchased is 4,000,000 (representing 14.94% of the Company's issued ordinary share capital at the time of this resolution);

    (b) the minimum price which may be paid for each ordinary share is £0.01 (1p) which amount shall be exclusive of expenses, if any;

Notice of meeting

Continued

(c) the maximum price, exclusive of any expenses, which may be paid for any ordinary share is an amount equal to 105% of the average of the middle market quotations for the ordinary shares of the Company as derived from the Daily Official List of the London Stock Exchange plc for the five business days immediately preceding the date on which such share is contracted to be purchased;

(d) unless previously renewed, revoked or varied, this authority shall expire at the conclusion of the annual general meeting in 2007 or 15 months after the passing of this resolution (whichever is the earlier); and

under this authority the Company may make a contract to purchase ordinary shares which would or might be executed wholly or partly after the expiry of this authority and may make purchases of ordinary shares pursuant to it as if this authority had not expired.

By order of the Board

D F Allison
Company Secretary
15th September 2006

Registered office
10 Eastcheap
London EC3M 1LX

Registered in England and Wales No 2685257

Notes to the Notice of Annual General Meeting

1. A member entitled to receive notice, attend and vote at the annual general meeting ("AGM") is entitled to appoint a proxy or proxies to attend and, on a poll, vote instead of him. Such proxy need not be a member of the Company. Completion of a form of proxy does not preclude the member attending the meeting and voting in person if they so wish. To be valid, the instrument appointing a proxy, together, if appropriate, with a power of attorney or other authority (if any) under which it is signed, or a notarially certified copy of such authority, must be deposited at the offices of the Company's registrars, Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU not less than 48 hours before the time fixed for the holding of the meeting. A form of proxy accompanies this notice.

2. Pursuant to regulation 41 of the Uncertificated Securities Regulations 2001, the time by which a person must be entered on the register of members of the Company in order to have the right to attend and vote at the annual general meeting (and for the purposes of the determination by the Company of the numbers of votes they may cast) is *11.30 am on 28th October 2006.* The rights of members to attend and vote at the meeting will be determined by reference to entries on the register of members at *11.30 am on 28th October 2006.* Changes to entries on the register of members of the Company after that time will be disregarded in determining the rights of any person to attend or vote at the meeting.

3. In the case of joint holders, the signature of only one of the joint holders is required on the form of proxy, but the vote of the first named on the register of members will be accepted to the exclusion of the other joint holders.

4. The following documents are available for inspection at the place of the AGM from 15 minutes prior to the meeting until the conclusion thereof:

   a) The register of interests of the directors (and their families) in the share capital of the Company.

   b) Copies of the directors' contracts of service and letters of appointment of the non-executive directors.

   c) Terms of reference of the Audit, Remuneration and Nominations Committees.

Explanation of the business of the Annual General Meeting

Report and accounts (Resolution 1)

The first item on the agenda requires that the directors must present the accounts of the Company for the year ended 31st May 2006 together with the directors' report and the independent auditors' report thereon.

Re-appointment of directors (Resolutions 2-8)

The Company's articles of association require that at every annual general meeting, one-third of the directors or, if their number is not three or a multiple of three, the number nearest to one-third shall retire from office. This year following the adoption of new articles of association all directors who have been in office for more than three years or have been appointed by the directors since the last annual general meeting of the Company will stand for re-appointment.

Article 137 of the Company's articles of association requires that a resolution for the appointment or re-appointment of two or more persons as directors by a single motion may not be moved unless a resolution that it shall be so moved has first been agreed to by the meeting without any vote being given against it. Consequently separate resolutions will be put to the meeting.

Re-appointment of Auditors (Resolution 9)

The Company is required at each general meeting at which accounts are laid before the shareholders to appoint auditors to hold office from the conclusion of the annual general meeting until the conclusion of the next annual general meeting. Moore Stephens LLP are the current auditors and have indicated their willingness to continue in office. If Resolution 9 is passed, Moore Stephens LLP will be re-appointed as auditors to the Company.

Purchase by the Company of its own shares (Resolution 10)

Under section 166 of the Companies Act, the directors of a company may make market purchases of that company's shares if authorised to do so. The Company's articles of association give a general authority to the directors to purchase shares on the market but that authority is subject to the approval of shareholders. Your directors believe that granting such approval would be in the best interests of shareholders in allowing directors the flexibility to react promptly to circumstances requiring market purchases.

Accordingly, Resolution 10, which will be proposed as a special resolution, will give the directors the authority to purchase issued shares of the Company under section 166 of the Companies Act. The authority contained in this Resolution will be limited to an aggregate nominal value of £40,000 which represents 14.49% of the issued ordinary share capital of the Company as at 15th September 2006. The price which may be paid for those shares is also restricted as set out in the Resolution. This authority will expire at the conclusion of the Company's annual general meeting in 2007 or 15 months after the passing of this resolution (whichever is the earlier).

The board has no present intention of exercising this authority. However, this will be kept under review, and the board will use this power only if and when, taking account of market conditions prevailing at the time, other investment opportunities, appropriate gearing levels and the overall financial position of the group, they believe that the effect of such purchases will be in the best interests of shareholders generally and that they will result in an increase in earnings per share.

Shares purchased under this authority may be held as treasury shares. The Company may purchase and hold shares as treasury shares up to a maximum amount equal to 10% of the nominal value of the issued ordinary share capital at that time, rather than cancelling them. Shares held in treasury do not carry voting rights and no dividends will be paid on any such shares. Shares held in treasury in this way can be sold for cash or cancelled. This would allow the Company to manage its capital base more effectively and to replenish its distributable reserves.

If and when the board resolves to exercise its authority to make market purchases, it will at that time decide whether shares purchased are to be cancelled or held in treasury.

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