

Introduction

Following publication of the Higgs Report in January 2003, the Financial Services Authority introduced a new Combined Code on corporate governance which came into effect for financial periods commencing on or after 1 November 2003. This report explains the manner in which the company has applied the principles of the Combined Code, as set out in more detail below.

The Board

The board has overall responsibility to shareholders for the management of the group. The primary function of the board is to set the group's strategy and to oversee the effective implementation of that strategy. A formal schedule of matters to be considered by the board is in place and is reviewed annually. The board is responsible for matters such as the annual budget (including capital expenditure), major acquisitions and disposals, succession planning, investment strategy, dividend policy, substantial property transactions, and the group's system of internal controls. Decisions on operational matters are delegated to the executive directors. There is an established agenda of items to be considered at board meetings which provides regular updates on the group's finances, operations, strategy and development. The board also receives presentations from executive directors and from divisional management and other senior executives on specific issues. The chairman meets separately with the chief executive on a regular basis and other informal meetings and discussions take place between directors as appropriate. The board receives monthly written reports from the chief executive, chief financial officer and chief operating officer as well as management accounts and other financial information. The board met formally on seven occasions during 2004; details of individual attendance by directors at board and committee meetings are set out in the table below.

	Board	Audit Committee	Remuneration Committee	Nomination Committee
		(attendance is shown only for committee members)		
Geoff Unwin	7			4
Clive Hollick	7			
Charles Gregson	7			
Malcolm Wall	7			
Nigel Wilson	7			
John Botts	7	4		4
Christopher Hyman	3 (of 5)	0 (of 2)		
Jonathan Newcomb	7	2 (of 4)	5	
Chris Powell	7		6	4
Adair Turner	7	4	6	
Fields Wicker-Miurin	2 (of 2)	2 (of 2)		

Board committees

The board is assisted in fulfilling its responsibilities by three principal committees, the audit, remuneration and nomination committees. Details of the activities of the audit committee are set out in a separate report on page 46 while those of the remuneration committee are set out in the remuneration report on pages 36 to 43.

The terms of reference for all committees were reviewed and updated during the year. These may be viewed on the company's website and copies can be obtained from the company secretary, who acts as secretary to all three committees.

Nomination committee

The nomination committee is chaired by Geoff Unwin and its other members are John Botts and Chris Powell. The committee meets as required to review the structure, size and composition of the board and to oversee the recruitment of new board members, both executive and non-executive. During 2004 the committee undertook a considerable workload in respect of succession planning for the role of chief executive as well as recruiting new non-executive directors. In addition to its four formal meetings, committee members undertook numerous other meetings and telephone discussions as well as interviewing prospective candidates.

The process of recruiting a new chief executive was initiated by the committee which drafted and agreed a specification for the role. Following consideration of a number of firms, external consultants were then selected to assist in the recruitment process. A large number of external and internal candidates were interviewed by the consultants and by the committee before selecting a shortlist of candidates who were interviewed by all non-executive directors.

A similar process was followed in respect of the recruitment of non-executive directors, where external consultants were engaged to identify suitable candidates in line with a specification produced by the committee. Potential candidates were then interviewed by the committee. The process has resulted in the appointment of two new independent non-executive directors, Christopher Hyman in May 2004 and Sandy Leitch in January 2005.

Board balance and independence

During 2004 there were ten board members in total, comprising the chairman (part-time), chief executive, three other executives and five non-executive directors. That number has increased to eleven with the appointment of a sixth non-executive director, Sandy Leitch, in January 2005. John Botts is the senior independent non-executive director. The board believes that a strong presence of non-executive directors is a key aspect of effective corporate governance. The board assesses and periodically reviews the independence of its non-executive directors; in doing so it has regard to the personal qualities demonstrated by each director, particularly the nature and effectiveness of his contribution to debate at board and committee meetings. The board has taken particular note of those factors which are listed in the Combined Code as possibly affecting the independence of directors, which are relevant to two directors. In both cases the board has concluded that these factors do not affect the independence of the individual director concerned. Adair Turner is a vice-chairman of Merrill Lynch Europe; this role is unconnected with the services provided by Merrill Lynch as one of the company's brokers. Chris Powell will have served as a director of the company for nine years in April; the board wishes to retain his services both as board member and as chairman of the remuneration committee in order to provide continuity following the arrival of the new group chief executive, and accordingly he will be proposed for re-election at the forthcoming annual general meeting and annually thereafter if appropriate. Biographies of all the directors currently in office are set out on pages 16 and 17 and illustrate their range of experience.

Under the company's articles of association, at each annual general meeting any director then in office who has been appointed by the board since the previous annual general meeting and any director who at the date of the notice convening the meeting had held office for more than thirty months since he was last appointed or re-appointed by the company in general meeting shall retire from office but is eligible for re-appointment. Non-executive directors' appointments are reviewed every three years.

The roles of chairman and chief executive are separate, and a summary of their respective responsibilities is set out in writing and has been approved by the board.

The chairman is responsible for overseeing the operation of the board but takes no part in the day to day running of the business. Prior to his appointment as chairman, Geoff Unwin was an independent non-executive director of the company. He is also chairman of Halma plc and Liberata plc, is a member of the advisory board of Hartwell plc and a non-voting director on the board of Cap Gemini. He was previously chairman of Trigenix Limited but relinquished this role during 2004.

Board evaluation

Evaluations of the performance of the board, its committees and individual directors were undertaken in 2004 by the following means:-

- The chairman's performance was evaluated by the non-executive directors in a meeting led by the senior independent director.
- Executive directors were evaluated by the chief executive as part of the annual appraisal process in place for all employees; the chief executive's appraisal was conducted by the chairman.
- Performance reviews in respect of those non-executive directors proposed for re-election at the 2004 annual general meeting were conducted by the chairman in "one-to-one" discussions with other board members. For those directors subject to re-election at this year's annual general meeting, a written assessment has been completed by all directors and the results collated and reported back to the board by the chairman.
- To enable the board to evaluate its own performance and that of its committees, all directors completed a detailed questionnaire and commentary on a confidential basis, the results being collated and reported back to the board by the company secretary.

Information and professional development

A procedure exists whereby directors may seek independent professional advice if they consider it appropriate to do so in the furtherance of their duties.

All directors have access to the advice and services of the company secretary, who has primary responsibility for keeping directors updated and informed of general developments which may be of relevance to their responsibilities. The company secretary is not a board director. All directors are offered the opportunity to further their professional development by means of attendance at seminars and briefings. An induction process is in place for all directors on appointment; this includes discussions with the chairman and chief executive as well as briefings from other directors and senior management on matters relating to the group's businesses and procedures. Non-executive directors are encouraged to meet with members of senior management on an individual basis and to visit the group's operations.

All board members also participate in the group's annual management conference which is attended by senior divisional and head office executives and affords a valuable opportunity for discussion of the group's strategy and its businesses.

Relations with shareholders

The company's shareholders are kept informed about the activities and progress of the group primarily by means of the annual and interim reports, and by the publication of updated trading information prior to the start of each close period and at the annual general meeting. Other performance indicators for specific businesses are also published periodically. Financial and other information about the company is published on its website, which has links to the websites of other businesses in the group.

The company maintains an ongoing dialogue with its major institutional shareholders by means of meetings and presentations as appropriate. These are generally undertaken by the chief executive, chief financial officer, chief operating officer and director of communications and may be attended if appropriate by the chairman or senior independent director. The chairman is responsible for ensuring that the views of shareholders are communicated to other directors. Feedback from investor meetings is provided to all directors, as are analysts' and brokers' reports. An independent survey of investors is also carried out periodically by the company's external IR consultants and the results presented by them to the board.

Consultation is undertaken with bodies representing shareholders' interests on matters which the company considers appropriate. All shareholders are welcome at the annual general meeting where they have the opportunity to ask questions of all the directors, including the chairman, as well as the chairmen of the audit and remuneration committees.

Internal control

The board is responsible for maintaining the effectiveness of the group's system of internal controls and for reviewing the effectiveness of such systems. The system is intended to enable the group to identify and manage the risks inherent in its business and accordingly can provide only reasonable and not absolute assurance against material mis-statement or loss.

A formal process is in place for identifying, evaluating and managing the key financial, operating and compliance risks faced by the group. This risk mapping process, which was in place throughout 2004 and continues in force, accords with the Turnbull guidance issued in September 1999 and is reviewed annually by the board. The process, which is undertaken at a divisional level, aims to identify and evaluate risks which are specific to each of the group's businesses. The results are co-ordinated by the internal audit department, reviewed centrally by senior management, and considered by the audit committee, which in turn reports to the board. The process established for the group includes the following:-

- All staff are required to comply with a formal system of delegated authorities which is in place for all divisions and head office.
- Further guidance on group policies and procedures is set out in various manuals including the financial policies and procedures manual, group policy manual and employee handbooks.
- An anti malpractice policy is in place throughout the group which provides a mechanism for confidential reporting by staff of possible concerns about financial or other matters.
- Treasury operations and taxation matters are considered by the finance committee, a management committee which operates within specified delegated authorities and reports to the board. Meetings are customarily attended by the chief executive, chief financial officer, deputy CFO, company secretary, head of taxation and head of treasury.
- The group has a comprehensive financial reporting system, with the annual budget being approved by the board and monthly trading results, balance sheets and cashflow summaries recorded against corresponding figures for the budget and the previous year.
- The chief executive and chief financial officer are responsible for certifying the company's annual financial statements, which process is supported by certification for the individual businesses from divisional CEOs and finance directors. This process is supported by a disclosure committee, chaired by the company secretary, which reviews the information contained in the company's financial statements and results presentations, and the method by which such information is gathered and evaluated by senior management.
- Established procedures are in place for the evaluation of potential acquisitions and their integration into the group, including the provision of detailed business plans and monitoring of post acquisition performance against such plans.
- The internal audit department undertakes periodic reviews of individual businesses to assess their control status and makes recommendations to the audit committee. The work of the internal audit department is prioritised to concentrate on the areas of greatest risk as identified through the group risk management process. The head of internal audit attends meetings of the audit committee, which oversees the role and structure of the internal audit department and makes recommendations to management.

Compliance with Combined Code

The foregoing statement sets out the manner in which the company has applied the principles of the Combined Code. The company considers that it complies with the provisions of section 1 of the Combined Code, save in relation to the requirement for non-executive directors (and specifically the senior independent director) to meet major shareholders. The board considers that it is appropriate to have in place a clearly defined process for communication with its shareholders as outlined above. During the year no requests were received from shareholders to meet with non-executive directors and no such meetings were offered. The board's views on the independence of non-executive directors are also set out on page 45.

THE AUDIT COMMITTEE

The audit committee is chaired by Adair Turner and its other members are John Botts, Jonathan Newcomb and Christopher Hyman, all of whom are independent non-executive directors. Fields Wicker-Miurin, also an independent non-executive director, was a member of the committee until her retirement from the board in May 2004. The committee meets at least four times a year; it met four times during 2004 and details of individual attendance are set out in the table on page 44. Members of the committee have broad financial experience which has been gained in a variety of disciplines, and which the board considers appropriate to enable the committee to carry out its responsibilities. The company secretary is secretary to the committee and others invited to attend committee meetings include the chief financial officer, deputy CFO, head of internal audit, head of taxation and the external auditors. The committee chairman also meets at least once a year with external auditors without management present.

The committee operates within written terms of reference. Its responsibilities include the following:-

- Review of the interim and annual financial statements and other formal announcements relating to financial performance.
- Review of the adequacy of the group's internal central and risk management processes, and of the company's disclosure on internal controls and procedures.
- The appointment, remuneration and oversight of the external auditor, including monitoring the auditor's independence and objectivity and the effectiveness of the audit process.
- Review of the internal audit programme, ensuring that the internal audit function is adequately resourced and has appropriate standing within the company and generally monitoring its effectiveness.
- Ensuring that procedures are in place to deal with complaints regarding accounting or audit matters.

To assist in ensuring auditor objectivity and independence, the audit committee has established a formal procedure regarding the undertaking of non-audit services by the external auditor, which identifies a number of categories of work where the auditors will not normally be employed, including financial due diligence on potential acquisitions and financial systems consultancy. Appointment of the external auditor for other non-audit services may only be made with the prior approval of the audit committee. Approval for projects with anticipated fees not exceeding specified limits is delegated to the chief financial officer or deputy CFO and is reported to the committee.

A review of auditor effectiveness and independence has also been conducted by executive management, following the guidelines established by the ICAEW and ICAS, and considered by the committee.