# Board report on corporate governance

## Combined code

The Directors are committed to the highest standards of corporate governance, corporate responsibility and risk management in directing and controlling the Group. The Company has throughout the year complied with the provisions of Section 1 of the Combined Code on Corporate Governance issued by the UK Financial Services Authority. The way in which the principles of good governance are applied is described below.

The Directors have agreed action that will raise the level of compliance with the suggested revised Code on Corporate Governance contained in the UK Government sponsored independent review of the role and effectiveness of non-executive Directors published on 20 January 2003 (the "Higgs Review").

## The Board

The Board comprises a Chairman, a Chief Executive, five other executive Directors and six non-executive Directors, four of whom the Board consider independent. Biographical details of the Directors are shown on pages 26 and 27.

There is a division of responsibility between the Chairman, Jeff Harris, who is responsible for the effective operation of the Board and the Chief Executive, Stefano Pessina, who is responsible for the performance of the Group's businesses. The Chairman and Chief Executive each have terms of reference that include provision that they must ensure there is agreement between them on the division of responsibilities.

The senior independent non-executive Director is Ken Clarke. The role has terms of reference that include the provision that he is available to shareholders if they have a concern which contact through the normal channels of Chairman or Chief Executive is inappropriate or has failed to resolve.

Non-executive Directors are appointed for a fixed term, normally of three years. At each Annual General Meeting, approximately one-third of the Directors and any Director who has served for more than three years without being proposed for re-election at an Annual General Meeting, retire by rotation and seek re-election.

## Operation of the Board

The Directors met eight times in 2002 and are scheduled to meet at least seven times in 2003. Additional meetings will be held as required.

The Board has adopted principles of good boardroom practice. These principles ensure that the Directors can perform their role effectively and that the Directors are given the means and information necessary for them to make informed decisions. The principles include details of:

- the legal responsibilities of Directors;
- the role and appointment of non-executive Directors;
- the procedures by which Directors are given and can obtain information, training and independent advice;
- the procedures for the provision of notices, agendas, papers and minutes for meetings of the Board and Board committees; and
- how meetings of the Board and Board committees are conducted.

The Board is collectively responsible for promoting the success of the Group by directing and supervising the Group's affairs. There is a schedule of matters reserved for approval by the Board, which ensures that it takes all major strategy, policy and investment decisions affecting the Group. This schedule is reviewed annually and includes specific matters under the categories of legal, stock exchange, strategic management control, Board membership, Board committees, capital and revenue commitments, financing, advisers and employees. At each meeting, the Board receives a report on current trading and major business issues and annually agrees the operating plan for the following financial year.

The Company Secretary attends all meetings of the Board and of Board committees and all Directors have access to his advice and services. The appointment and removal of the Company Secretary is a matter reserved for the whole Board.

## Board committees

The Board has delegated specific responsibilities to four Board committees. The membership of these Board committees and a summary of their main duties under their terms of reference are as follows.

## Audit committee

The audit committee consists of three non-executive Directors, all of which are independent: Neil Cross (Chairman), Patrick Ponsolle and Paolo Scaroni. Others normally attending meetings in advisory capacities are the Group Finance Director, the Director of Internal Audit, the Group Financial Controller, the Director of Financial Structuring and representatives from the external auditors. The committee met three times in 2002.

The duties of the audit committee are to:

- consider any change to, independence of, objectivity of and fees to the external auditors;
- with the external auditors, discuss the scope and nature of the audit, review their quality control procedures, ensure coordination of audits, review their management letter and management's response and discuss any issues arising from their audit;
- review the programme, resourcing and results of the internal audit function and approve any change to the Director of Internal Audit;
- review the Group's procedures for handling allegations from whistle-blowers;
- review reports on the effectiveness of systems for internal financial control, financial reporting and risk management;
- monitor the integrity of the financial statements of the Group;
- review the consistency of accounting policies;
- monitor compliance with the Group's borrowing limits; and
- monitor compliance with the principles of good boardroom practice.

The Group has a policy of not awarding management consultancy assignments to the external auditors except where they have specific knowledge not available to others. The Group has a preference to use its external auditors for due diligence assignments on potential acquisitions where their knowledge of the industry can provide insights useful in assessing the target company and its fit with the Group. Tax related work is shared between a small number of selected firms, including the Group's external auditors. The Group is working towards ensuring that its principal external auditors will audit all major subsidiaries in due course.

## Executive committee

The executive committee, chaired by Geoff Cooper, consists of the executive Directors. Since December 2002, the executive committee has taken over responsibility for matters previously delegated to the management board. The management board met thirteen times in 2002.

The duties of the executive committee are to:

- run the Group on a day by day basis;
- implement decisions of the Board;
- attend to all matters not reserved for approval by the Board or delegated by the Board to other Board committees; and
- attend to all matters delegated to it.

## Nomination committee

The nomination committee consists of five Directors, three of whom are independent non-executives: Ken Clarke (Chairman), Jeff Harris, Stefano Pessina, Neil Cross and Patrick Ponsolle. The nomination committee met twice in 2002.

The duties of the nomination committee are to:

- review the structure, size and composition of the Board;
- nominate candidates to fill vacancies in the Board having evaluated the skills, knowledge and experience required;
- ensure succession plans are in place for executive Directors;
- recommend the re-appointment of Directors; and
- nominate candidates for senior Board positions.

## Remuneration committee

The remuneration committee consists of three independent non-executive Directors: Ken Clarke (Chairman), Neil Cross and Patrick Ponsolle. Jeff Harris and Stefano Pessina attend meetings in advisory capacities but are not present when their own remuneration is discussed. The remuneration committee met six times in 2002.

The duties of the remuneration committee are to:

- determine the Group's remuneration policy for executive Directors and senior executives;
- determine the remuneration of the executive Directors;
- ensure that payments made on termination of employment of executive Directors are fair to both parties;
- execute standard employment contracts with executive Directors;
- recommend any changes in terms and conditions of employment of executive Directors;
- approve the annual Board report on remuneration;
- agree the policy on authorising expenses from the Chairman and from the Chief Executive; and
- grant options under and agree amendments to the rules of the discretionary share option schemes.

The Board report on remuneration provides details on how the committee exercises these duties.

# Board report on corporate governance (continued)

## Investor relations

The Company values its interaction with both private and institutional investors. Institutional shareholders, fund managers and analysts are kept informed of the overall strategy of the Group through regular meetings and presentations.

The AGM is seen as the main opportunity for private investors to communicate with the Directors face to face. To facilitate this:

- notices convening AGMs are sent to shareholders at least 20 working days before a meeting;
- the document containing the notice of the relevant AGM will include a commentary on the business of the meeting and notes to help shareholders exercise their rights at the meeting;
- all shareholders, whether they can attend an AGM or not, are encouraged to ask questions; and
- it is the intention of all Directors to be present at AGMs.

## Financial reporting and going concern

The Directors have acknowledged their responsibilities in relation to the financial statements in the Directors' responsibilities statement. The Directors are also responsible for the publication of unaudited interim reports of the Group that provide balanced and understandable assessments of the Group's financial position for the first six months of each accounting period. The same standards are applied to other price sensitive public reports and reports to regulators, as well as information provided to satisfy statutory requirements.

After making appropriate enquiries, the Directors consider that the Company has adequate resources to continue in operational existence for the near future and therefore have continued to adopt the going concern basis in preparing the financial statements.

## Internal controls

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. The system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable, and not absolute, assurances against material misstatement or loss. The Board considers risk assessment and control to be fundamental to achieving its corporate objectives within an acceptable risk/reward profile and confirms that there is an ongoing process for identifying and combating significant risks in the Group controls. The effectiveness of the internal control system is reviewed annually by the audit committee on behalf of the Board and throughout 2002 and up until the date of this report accords with the Turnbull internal control guidance for Directors as required by the Combined Code.

Key elements of the Group's system of internal controls are as follows:

- regular Board meetings with a formal schedule of matters reserved by the Board for decision;
- Board approval of business strategies, medium term business plans and annual operating plans;
- an annual risk review by the audit committee, based on a detailed self-assessment by management of all business risks in terms of impact, likelihood and control strength;
- clearly defined organisational structures and appropriate delegated authorities for the Group's business;
- monthly review by the executive committee of key performance indicators to assess progress towards objectives, action being taken as required;
- continuous monitoring of regulatory developments;
- procedures for planning, approving and monitoring business acquisitions, divestments and capital expenditure projects, supplemented by post-investment performance reviews;
- dispensing and professional pharmacy protocols;
- procedures for security and specialist handling of certain drug classes;
- a rolling programme of surveys by the Group's insurance brokers to advise on physical risks;
- centralised treasury operations operating within defined limits and subject to regular reporting requirements;
- an effective internal audit function to provide independent scrutiny of internal control systems and risk management procedures;
- regular monitoring of risks and control systems throughout the year by operating businesses; and,
- a self-certification process, whereby operating businesses are required to confirm that the system of internal control is operating effectively.