

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 throughout the year complied with the provisions of Section 1 of the Combined Code on Corporate Governance issued by the UK Financial Services Authority which applied to this period.

The Directors have agreed action that will raise the level of compliance in 2004 with the revised Combined Code on Corporate Governance issued by the UK Financial Services Authority on 23 July 2003, which applies for reporting years beginning on or after 1 November 2003. The way in which the principles of good corporate governance are applied, along with comment and explanation relating to significant extra disclosures under the revised Combined Code, are described below.

The Board

The Board comprises a non-executive Chairman whom the Board considers to be non-independent, an independent non-executive Deputy Chairman, a Chief Executive, five other executive Directors and seven other non-executive Directors, five of whom the Board considers to be independent. Biographical details of the Directors are shown on pages 28 and 29.

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.

Jeff Harris was appointed Chairman in September 2001. In April 2003 he retired as a full time executive, continuing as Chairman in a non-executive capacity. He joined the Group in 1985, was appointed to the Board in 1986 and held the position of Chief Executive from 1992 to 2001. The Directors are of the opinion that his extensive industry and business specific knowledge and experience, gained during 17 years as an executive Director, are extremely beneficial to the Board and that his ongoing chairmanship provides valuable continuity to develop the business in the best interests of shareholders and customers.

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 for which contact through the normal channels of Chairman or Chief Executive is inappropriate or which such contact has failed to resolve. The senior independent non-executive Director periodically holds meetings with the other non-executive Directors outside the presence of executive Directors.

At each AGM, at least one-third of the Directors and any Director who has served for more than three years without being proposed for re-election at an AGM retire by rotation and seek re-election.

The Board does not have a majority of independent non-executive Directors, as required by the revised Combined Code; steps have been taken to address this by the appointment of two additional independent non-executive Directors in 2003. The balance between independent and non-independent Directors will further change when Claude Berretti retires at the conclusion of the AGM. The additional appointments have also broadened the pool of independent non-executive Directors who can serve on committees, such that undue reliance is not placed on particular individuals. It is considered that the composition of the Board has the balance of skills and experience appropriate for the requirements of the business and that no small group of individuals can dominate the Board's decision making.

Operation of the Board

The Directors met nine times as a Board in 2003 and are scheduled to meet at least eight times in 2004. Additional meetings are held as required. The attendance record for the Board meetings held in 2003, as required by the revised Combined Code, is shown below.

The Board has adopted principles of good boardroom practice. These principles ensure that the Directors can perform their role effectively and 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 scheduled 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 Board delegates day to day management of the Group to the executive committee.

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 Board. In July 2003 Marco Pagni was appointed General Counsel and Company Secretary, replacing Adrian Goodenough who had served as Company Secretary since 1990.

During the year the Board undertook a formal and rigorous evaluation of its own performance including that of the Board committees. This evaluation was carried out by an independent firm of management consultants.

Board committees

The Board has delegated specific responsibilities to four Board committees. The attendance record, as required by the revised Combined Code, membership of these Board committees and a summary of their main duties under their terms of reference are shown below.

Meeting attendance record

	Board	Executive committee	Audit committee	Remuneration committee	Nomination committee
Number of meetings in 2003	9	16	4	3	6
Director					
J.F. Harris	9	–	–	–	5
K.H. Clarke	9	–	–	3	5
S. Pessina	9	16	–	–	5
G.I. Cooper	9	16	–	–	–
G.R. Fairweather	9	16	–	–	–
O. Barra	9	16	–	–	–
P. Utnegaard ⁽¹⁾	4	6	–	–	–
S.W.J. Duncan ⁽²⁾	8	16	–	–	–
C. Etherington ⁽³⁾	2	3	–	–	–
N.E. Cross	9	–	4	3	6
A.W. Loader ⁽⁴⁾	1	–	–	–	–
P. Ponsolle	8	–	4	3	4
P. Scaroni	5	–	1	–	–
M. Stach ⁽⁵⁾	–	–	–	–	–
C.J.S. Berretti	6	–	–	–	–
E. Jornod	5	–	–	–	–

⁽¹⁾appointed to the Board in September 2003; four Board meetings and six executive committee meetings were held after his appointment

⁽²⁾appointed to the Board in January 2003; eight Board meetings and 16 executive committee meetings were held after his appointment

⁽³⁾resigned from the Board in March 2003

⁽⁴⁾appointed to the Board and audit committee in September 2003; three Board meetings were held after his appointment but no audit committee meetings; appointed to the remuneration committee in February 2004

⁽⁵⁾appointed to the Board in December 2003; no Board meetings were held after his appointment; appointed to the audit committee in February 2004

Executive committee

The executive committee, chaired by Geoff Cooper, consists of the executive Directors. The executive committee met 16 times in 2003.

The duties of the executive committee are to:

- run the Group on a day to 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.

Audit committee

The audit committee consists of five independent non-executive Directors: Neil Cross (Chairman), Adrian Loader, Patrick Ponsolle, Paolo Scaroni and Manfred Stach. Others normally attending meetings in advisory capacities are the Group Finance Director, the Director of Internal Audit, the Group Financial Controller, the General Counsel and Company Secretary and representatives from the external auditors. The committee met four times in 2003.

The duties of the audit committee are to:

- consider the appointment, re-appointment and/or removal of the external auditor;
- consider any change to, independence of, objectivity of and fees to the external auditors;
- consider the effectiveness of the external audit process taking into consideration relevant UK professional and regulatory requirements;
- maintain and monitor a policy on the engagement of the external auditor to supply non-audit services;
- agree with the external auditors the scope and nature of their 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, effectiveness and results of the internal audit function and approve any change to the Director of Internal Audit;
- oversee the process for dealing with complaints received by the Group regarding accounting, internal accounting controls or auditing matters and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters;
- review the effectiveness of systems for internal financial control, financial reporting and risk management;
- monitor, review and challenge where necessary the integrity of financial statements and formal announcements relating to the financial performance 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.

Board report on corporate governance (continued)

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 certain 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's principal external auditors will audit all major subsidiaries with effect from 2004.

In accordance with the above duties, particular areas of focus of the audit committee during 2003 included:

- a review of the Internal Audit function;
- the appointment of a new Director of Internal Audit;
- the implementation by January 2004 of a policy to ensure that the principal external auditors audit all major subsidiaries;
- agreement of a policy for the approval of non-audit services provided by external auditors;
- a review of post-investment audits; and
- the implementation of an effective system for dealing with complaints received by the Group regarding accounting, internal accounting controls or auditing matters and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

Remuneration committee

The remuneration committee consists of four independent non-executive Directors: Ken Clarke (Chairman), Neil Cross, Adrian Loader 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 three times in 2003.

The duties of the remuneration committee are to:

- determine the Group's remuneration policy for executive Directors and executive management;
- determine the remuneration for the Chairman and the executive Directors;

- ensure that payments made on termination of employment of executive Directors are fair to both parties;
- execute standard service 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.

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 six times in 2003.

The principal duties of the nomination committee are to:

- review regularly the structure, size and composition of the Board;
- identify and nominate candidates to fill vacancies on the Board;
- review annually the time required from non-executive Directors and evaluate whether each non-executive Director is spending sufficient time to fulfil his duties;
- ensure succession plans are in place for Directors and, in particular, for the Chairman and Chief Executive;
- recommend the re-appointment of Directors taking into account the evaluation of individual performance; and
- recommend candidates for senior Board positions.

Appointments to the Board are made on merit and against objective criteria, taking into account the balance of skills, knowledge and experience required. External search consultants are used to recruit executive and non-executive Directors. The non-executive Directors confirm that they have sufficient time available to devote to their role.

A rigorous, wide-ranging review process was undertaken for the selection and appointment of the two additional non-executive Directors and the appointment of the Wholesale Director during the year, in recognition of the need to refresh the membership of the Board and to broaden further the level of international experience.

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.

The senior independent Director took steps to arrange to meet and understand the views of major shareholders.

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 2003 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 businesses;
- 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 providing 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 in writing that the system of internal control is operating effectively.