

## Board report on corporate governance

The Board is committed to meeting the standards of good corporate governance set out in the Code. This report, together with the audit committee report on pages 52 and 53 and the Board report on remuneration on pages 54 to 62, describes how the Board applied the Code during the year under review.

### The Board

The Board currently comprises the Chairman, five executive Directors and six non-executive Directors. The names of the Directors together with their biographical details are set out on pages 44 and 45. Jeff Harris stepped down as Chairman of the Company and retired from the Board at the conclusion of the 2005 AGM. Per Utnegaard resigned as a Director on 17 March 2005. The roles of the Chairman, Chief Executive and Executive Deputy Chairman have been set out in writing and approved by the Board. The executive Directors' service contracts and the letters setting out the terms of appointment of the non-executive Directors are available for inspection by any person at the Company's registered office during normal business hours and at the AGM.

### Chairman

Paolo Scaroni, who is responsible for the operation of the Board, was appointed as Chairman in April 2005, having been an independent non-executive Director since December 2002. On his appointment as Chairman, Paolo Scaroni met the independence criteria set out in the Code.

### Chief Executive

Ian Meakins is responsible for leading the Group's businesses and managing the Group on a day-to-day basis within the authorities delegated by the Board.

### Executive Deputy Chairman

Stefano Pessina, in addition to his role as Executive Deputy Chairman, has operational responsibility for strategic development, including acquisitions.

### Operation of the Board

The Board met eleven times in 2005. The Board is scheduled to meet nine times in 2006, with additional meetings held as required. The attendance record for Board and committee meetings, including the AGM, is set out on page 51.

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

- the legal responsibilities of Directors;
- the role and appointment of non-executive Directors;
- the procedure by which Directors are given and can obtain information, training and independent advice;
- the procedure 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, risk management, Board membership, Board committees, capital and revenue commitments, financing, advisors and employees.

At each scheduled Board meeting, the Board receives a report on current trading and major business issues. The Board also reviews annually the Group's strategic plan and approves a budget for the following financial year. The Board monitors the Group's overall system of internal controls, governance and compliance and has approved formal delegated powers giving the executive committee day-to-day management of the Group.

### Directors' and officers' insurance

The Company maintains an appropriate level of Directors' and officers' insurance in respect of legal action against Directors. In accordance with recent changes in the law, the Company, under its Articles of Association, granted deeds of indemnity to each of the Directors and to the Company Secretary.

### Board balance and independence

The Board has reviewed the independence of all the non-executive Directors and determined that of the seven non-executive Directors, six are independent. Etienne Jornod is Chairman and Chief Executive of Galenica, an associate company, and therefore is considered to be non-independent. Galenica is entitled, as long as the associate agreement exists between it and the Company, to designate one Director for appointment to the Board of the Company, subject to the approval of the Company's shareholders.

Throughout the year, the Company has not complied with the Code requirement that at least half of the Board, excluding the Chairman, should comprise non-executive Directors determined by the Board to be independent. However, there is a broad 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 Board has the balance of skills and experience appropriate for the requirements of the Group and that no individual or group of individuals unduly influences the Board's decision making.

The senior independent non-executive Director is Kenneth Clarke. The role's terms of reference provide that he is available to shareholders if they have a concern that would make contact through the normal channels of Chairman or Chief Executive inappropriate, or if a concern has not been resolved by such contact. The senior independent non-executive Director periodically holds meetings with the other non-executive Directors without the executive Directors present.

A procedure is in place for Directors, if they wish, to receive independent professional advice in respect of their duties. They also have access to the advice and services of the Company Secretary who is charged with ensuring that Board procedures are followed and that good corporate governance and compliance is implemented throughout the Group. The Company Secretary normally attends all meetings of the Board and Board committees. The appointment and removal of the Company Secretary is a matter reserved for the Board. The Board and its committees are supplied with full and timely information which enables them to discharge their responsibilities. In addition to the papers circulated to the Board in advance of Board and committee meetings, reports are sent to the Directors in months when the Board is not scheduled to meet. The Company Secretary ensures good information flows within the Board and its committees and between the non-executive Directors and management. New Directors receive appropriate induction training on joining the Board, including site visits and meetings with senior management.

#### Performance evaluation

During the year, the Board formally evaluated its own performance and that of the Board committees, which included a "follow up" of matters raised in the evaluation carried out by the Board in the previous year. This process was in the form of a questionnaire, supplemented by one-to-one meetings between the Chairman and each of the non-executive Directors, where individual performance was discussed. The non-executive Directors met separately to discuss the performance of the Chairman. Issues arising from the self assessment evaluation were presented to the Board by the Chairman with an action plan to ensure continuous improvement in the operation of the Board and its committees. The evaluation of the personal performance of the executive Directors was based on a 360-degree appraisal process, which was considered by the nomination and the remuneration committees.

#### Re-election of Directors

All Directors are required to be elected by shareholders at the AGM following their appointment by the Board and then re-elected at least once every three years. In accordance with the Articles of Association of the Company, one-third of the Directors (excluding new appointments) must stand for re-election at each AGM. Non-executive Directors are normally appointed for an initial term of three years which is then renewed and extended for not more than two further three year terms.

In accordance with Company policy, it had previously been agreed that Neil Cross who has now served nine years as a non-executive Director would retire from the Board at the conclusion of the 2006 AGM. In view of the Company's proposed merger with Boots, the nomination committee has suspended the process to identify a candidate with recent and relevant financial experience to succeed Neil Cross as a non-executive Director and as Chairman of the audit committee. In accordance with the Company's Articles of Association and the Code, which require non-executive Directors serving longer than nine years to seek annual re-election, Neil Cross will seek re-election at the 2006 AGM for a period up until the conclusion of the 2007 AGM. The other Directors coming up for re-election at the 2006 AGM are George Fairweather, Ornella Barra, Patrick Ponsolle and Etienne Jornod.

Prior to recommending the re-election of non-executive Directors to the Board, the nomination committee reviews their effectiveness. The review process in 2005 concluded that all Directors continue to contribute effectively and with proper commitment, devoting adequate time to carry out their duties. The notice of this year's AGM confirms that the performance of the Directors being proposed for re-appointment continues to be effective.

#### Board committees

The Board has established four committees, the nomination, remuneration, audit and executive committees. Each committee has terms of reference, agreed by both the committee and the Board, which were reviewed during the year. With the exception of the executive committee, the terms of reference for each of these committees are published on the corporate website at [www.alliance-unichem.com](http://www.alliance-unichem.com). Regular reports of committee business and activities are given to the Board.

#### Nomination committee

The nomination committee consists of four independent non-executive Directors, Kenneth Clarke (committee Chairman), Neil Cross, Patrick Ponsolle and Manfred Stach and three other Directors, Paolo Scaroni, Ian Meakins and Stefano Pessina. The majority of the members of the committee are independent non-executive Directors as required by the Code. The committee met twice in 2005, the attendance record of members being shown in the table on page 51.

The duties of the nomination committee are to:

- regularly review the structure, size and composition of the Board;
- regularly review the skills, knowledge and experience of the Board and make recommendations to the Board with regard to any adjustments that are considered necessary;
- ensure succession plans are in existence for Directors; and
- keep under review the leadership needs of the Group.

As part of the ongoing review of succession, early in 2005 the committee instructed external consultants to identify candidates for a number of positions as independent non-executive Directors. This process involved an evaluation of the skills and experience required, including the need for at least one new independent non-executive Director to have recent and relevant financial experience to serve as Chairman of the audit committee. In view of the Company's proposed merger with Boots this process was suspended by the committee. Following a rigorous review conducted by the nomination committee, the Board is satisfied that Neil Cross, who has served on the Board for more than nine years, continues to contribute effectively and with proper commitment.

### Remuneration committee

The remuneration committee consists of three independent non-executive Directors, Kenneth Clarke (committee Chairman), Neil Cross and Adrian Loader. Patrick Ponsolle resigned from the committee in July 2005, having up until that date been a member of three Board committees. The Chairman, the Chief Executive and the Executive Deputy Chairman are invited to attend meetings as appropriate but are not present when their own remuneration is discussed. The committee met three times in 2005, the attendance record of members being shown in the table on page 51. The role of the committee and details of how it applied the principles of the Code and the Directors' Remuneration Report Regulations 2002 are set out in the Board report on remuneration on pages 54 to 62.

### Audit committee

The audit committee consists of four independent non-executive Directors, Neil Cross (committee Chairman), Adrian Loader, Patrick Ponsolle, and Manfred Stach. Paolo Scaroni on his appointment as Chairman of the Company resigned from the committee in accordance with the requirements of the Code. The role of the committee and details of how it carried out its duties are set out in the audit committee report on pages 52 and 53.

### Executive committee

The executive committee consists of the executive Directors and is chaired by Ian Meakins. The executive committee met 11 times in 2005.

The duties of the executive committee are to:

- oversee the operation of the Group;
- 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.

### Relations with shareholders

The Company organises a programme of formal and informal events, investor meetings, and presentations which take place throughout the year. This programme is led by the Chief Executive and the Group Finance Director and involves other members of the executive committee and the Director of Investor Relations. Meetings are held with institutional investors and analysts to discuss information made public by the Group and address any questions that may arise. The Company ensures that no price-sensitive information is disclosed in these meetings.

To ensure the Board is effectively informed of shareholders' views, the Company's brokers and the Director of Investor Relations seek to understand those views on an ongoing basis and provide regular feedback to the Board. The non-executive Directors are offered the opportunity to attend meetings with institutional investors and shareholder events. They also make themselves available to shareholders upon request. In addition to the programme described above, the Company's website provides financial and other information about the Group. Preliminary and interim results, as well as all announcements to the London Stock Exchange are published on the Company's corporate website.

All shareholders have the opportunity to attend the Company's AGM and to question the Directors on any issue relating to the Company. The Chairmen of the nomination, remuneration and audit committees are also present at the meeting to answer questions.

In accordance with best practice:

- the notice of the AGM is circulated to all shareholders at least 20 working days before the AGM;
- the proxy votes for and against each resolution, as well as abstentions, are made available at the meeting after shareholders have voted on each resolution on a show of hands, with the exception of the resolution in connection with the waiver of the obligations of Rule 9 of the City Code on Takeovers and Mergers which is voted on by a poll; and
- separate resolutions are proposed at the AGM on each substantially separate issue.

### Internal controls

The Board has overall responsibility for the Group's system of risk management and 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 an efficient risk management and control framework to be fundamental to the Company achieving its corporate objectives, with an actively managed balance of risk and reward. The effectiveness of the ongoing process to identify, evaluate and manage significant risks in the Group's system of risk management and internal controls is reviewed annually by the audit committee on behalf of the Board, the committee having responsibility for overseeing management action needed to remedy any shortcomings or weaknesses identified.

Throughout 2005 and up until the date of this report the risk management and internal controls systems comply with the revised Turnbull guidance for Directors as required by the 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 the Group's strategic plan and annual budget ;
- an annual risk review by the audit committee and subsequently by the Board, based on business risk reviews and control self assessments;
- clearly defined organisational structures and appropriate delegated authorities for the Group's businesses;
- monthly reviews by the executive committee of key performance indicators to assess progress towards objectives, with action being taken as required;
- continuous monitoring of regulatory developments;
- procedures for planning, approving, executing and monitoring business acquisitions, divestments and capital expenditure projects, supplemented by post-investment performance reviews;

## Meeting attendance record

	AGM	Board	Nomination committee	Remuneration committee	Audit committee	Executive committee
Number of meetings in 2005	1	11	2	3	4	11
<b>Director</b>						
P. Scaroni <sup>(1)</sup>	1	10	2	–	1	–
I. K. Meakins	1	11	2	–	–	11
S. Pessina	1	11	2	–	–	11
G. R. Fairweather	1	11	–	–	–	11
O. Barra	1	11	–	–	–	11
S. W. J. Duncan	1	11	–	–	–	11
K. H. Clarke	1	10	2	3	–	–
N. E. Cross	1	9	2	3	4	–
W. A. Loader	1	10	–	2	3	–
P. Ponsolle <sup>(2)</sup>	1	8	1	1	3	–
M. Stach <sup>(3)</sup>	1	10	–	–	4	–
E. Jornod	1	10	–	–	–	–
P. Utnegaard <sup>(4)</sup>	–	2	–	–	–	2
J. F. Harris <sup>(5)</sup>	1	3	1	–	–	–

(1) Resigned from the audit committee in April 2005 on his appointment as Chairman. One audit committee meeting was held before his resignation.

(2) Resigned from the remuneration committee in July 2005; two remuneration committee meetings were held before his resignation.

(3) Appointed to the nomination committee in January 2006.

(4) Resigned from the Board in March 2005; two Board meetings and three executive committee meetings were held before his resignation.

(5) Retired from the Board in April 2005; three Board meetings and one nomination committee meeting were held before his retirement.

- dispensing and professional pharmacy protocols which are reviewed and against which compliance is audited on a regular basis;
  - 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;
  - a Group internal audit function providing independent scrutiny of internal control systems and risk management procedures;
  - operational review teams within individual businesses providing management assurance on key controls primarily in wholesale depots and retail outlets;
  - regular monitoring of risks and control systems throughout the year by operating businesses, with periodic exception reporting;
  - a self-certification process, whereby operating businesses are required to confirm in writing that the system of internal control is operating effectively;
  - the Director of Internal Audit has the right of direct access to the audit committee and the Chairman of the Company;
  - continuous monitoring by the Group legal function of claims and litigation throughout the Group; and
  - a requirement for specialist legal, financial and other professional advice to be obtained as part of the Group's business activities.
- Compliance statement**  
The Company applied the principles of the Code throughout the year under review with the following exceptions:
- Code provision A.2.2 – for the period 1 January to 22 April 2005 – Jeff Harris, who was Chairman up until 22 April 2005, was Chief Executive of the Company prior to his appointment as Chairman;
  - Code provision A.3.2 – during the year, a majority of the members of the Board (excluding the Chairman) were not independent non-executive Directors; and
  - Code provision A.4.1 – for the period from 22 April – the nomination committee did not comprise a majority of independent non-executive Directors. Its membership did not change during 2005, however on his appointment as Chairman, Paolo Scaroni, a committee member, was no longer considered to be independent. Manfred Stach, an independent non-executive Director, was appointed as a member of the committee on 26 January 2006.