

## corporate governance

The requirements of corporate governance are set out in the Financial Services Authority (FSA) Listing Rules together with the related Principles of Good Governance and Code of Best Practice (the 'Combined Code'), adopted by the FSA.

Directors are assisted in complying with the internal control requirements of the Combined Code by the Institute of Chartered Accountants in England and Wales' publication 'Internal Control: Guidance for Directors on the Combined Code' (the 'Turnbull guidance').

The board considers that good corporate governance is an essential element of achieving its overall objectives. It has reviewed the group's corporate governance policies and practices, and has determined that during the period 1st April 2004 to 31st March 2005 the company complied with the provisions of the Combined Code.

### The board

On 31st March 2005, the board comprised the Chairman, three executive directors and five non-executive directors. There were no changes to the composition of the board during the year, although Mr Dodd resigned on 18th May 2005. During the year the board reviewed the composition of the board, and the balance of skills, knowledge and experience its members brought, and concluded that the board was of the appropriate size and balance for the company. Mr G N Dawson has been appointed the Senior Independent Director. Biographies and other details of members of the board of directors are shown on page 21 and in the AGM notice.

The Chairman meets with individual directors privately at least once a year to review their contribution to the board and personal development plans including training needs. Further, the Chairman meets with the non-executive directors as a group four times a year in the absence of the executive directors. As part of the board evaluation programme, the non-executive directors, led by the Senior Independent Director, meet annually without the Chairman being present to review the performance of the Chairman, having considered the views of the executive directors. During the year the board undertook a review of the board as a whole, its committees and its members, assisted by independent consultants. The review included confidential interviews with each director, when they had an opportunity to express their views on their overall impression of the board and its committees and their organisation, composition, involvement in the business and effectiveness; the roles and contributions of board members; communications with shareholders; stakeholder issues and succession planning. The results were consolidated and reported to the Chairman and, in so far as they related to the board as a whole, to the board and, in so far as they related to the Chairman, to the Senior Independent Director. The board considered the outcome of the programme in its evaluation of the skills, knowledge and experience of the board, and the nominations committee applies the output in formulating its development plans for the board.

Non-executive directors are appointed for an initial term of three years from the annual general meeting following their joining the board, and subject to performance and reappointment where appropriate, there is an expectation of renewal of that appointment for a further three-year

period. Exceptionally, non-executive directors may be invited to serve for a third and final three-year term. Non-executive directors' fees are determined by the board in the absence of the non-executive directors.

Details of executive directors' service contracts are given on page 35. All executive directors normally retire on reaching the age of 60. Details of the Chairman's appointment are given on page 34. Copies of service contracts and letters of appointment are available for inspection at the company's registered office and at the AGM.

All directors appointed by the board must stand for reappointment at the first AGM following their appointment, and thereafter at least every three years. In addition, at least one third of the continuing members of the board must retire, and if willing, stand for reappointment at each AGM. Directors retiring and those standing for reappointment at the 2005 AGM are identified on page 45.

The non-executive directors bring a variety of experience and expertise to the board and are all considered to be independent. Sir Nigel Rudd was considered by the board to be independent at the date of his appointment as Chairman. The board considers that an independent director is one who is independent in character and judgment, and where there are no relationships or circumstances which could affect the director's judgment. Relationships or circumstances which could affect judgment include having been previously an employee of the company, having had close ties with any of the company's advisors, directors or senior managers, having had a material relationship with the company, receiving additional remuneration from the company apart from directors fees, participating in the company's performance related pay or pension schemes, holding cross directorships, having significant links with other directors, representing a significant shareholder, or having served on the board for more than nine years.

The division of responsibilities between the Chairman and chief executive is in writing and has been agreed by the board. The Chairman's responsibilities broadly follow the guidance given in the Combined Code, while Richard Baker, the chief executive, is responsible for leading the executive management of the company in the achievement of the company's objectives, and for the proper and successful management of the business.

The board has a programme to enable it to discharge its responsibility for providing entrepreneurial leadership of the company within a framework of prudent and effective controls, and to assess and manage risk. The board has eight regular meetings in the year, including two strategy meetings, and other meetings are convened as required. In this year, two additional meetings took place.

The table overleaf shows the attendance of directors at board meetings and at meetings of the audit, nominations, remuneration and social responsibility committees during the year. All directors have attended meetings of the board and of committees of the board of which they are members unless prevented from doing so by prior commitments particularly in the case of additional meetings called at short notice.

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	Board		Audit Committee		Nominations Committee		Remuneration Committee		Social Responsibilities Committee	
	Attended	Maximum possible attendance	Attended	Maximum possible attendance	Attended	Maximum possible attendance	Attended	Maximum possible attendance	Attended	Maximum possible attendance
R A Baker	10	10								
P Bateman	9	10							4	4
J Bennink	8	10	1	4	1	1	3	5	3	4
G N Dawson	10	10	4	4	1	1				
H Dodd	10	10								
T C Parker	9	10	4	4	1	1	5	5	3	4
H Ploix	8	10	4	4	1	1	5	5	4	4
Dr M P Read	9	10			1	1	5	5		
Sir Nigel Rudd	10	10			1	1				

A schedule of matters reserved for decision by the board is maintained, including the approval of the annual report and accounts, the long-term objectives of the company, the strategy to achieve those objectives, the annual operating plan including the allocation of human and financial resources and against which business performance is assessed, significant investment and disposal decisions, the structure of the group, payment of dividends, changes in accounting policies and practices, remuneration of and changes to the auditors, treasury policies, and the appointment and removal of the company secretary. The board delegates to management the management of the business.

For all board meetings an agenda is established. For regular meetings this generally comprises: Reports from the chief executive, the chief financial officer and the HR and operations director, including a health and safety report: Reports on the performance of the businesses: Approval of major items of expenditure, and other significant policy issues. The board is also notified of any permissions given to directors and senior managers to deal in the securities of the company under the company's dealing code and receives reports from the committees of the board, to enable it to satisfy itself as to the matters within their remit. Appropriate papers are provided to the directors in advance of each board meeting. In addition the board considers at least annually the strategic plans of the group and of individual businesses, and from time to time directors receive presentations from management concerning key areas of the group's operations.

Full year and interim results are reviewed by the board audit committee and approved by the board prior to publication. Other price sensitive announcements may be published under the authority of a director.

The composition and terms of reference of board committees, and a summary of the current terms of reference and details of membership of major board committees during the year are set out on pages 29 and 30.

In the furtherance of their duties, the directors have full access to the services of the company secretary and may take independent professional advice, at cost to the company, subject to a limit of £25,000 and to prior notification to the chairman of the audit committee. In addition, each of the committees of the board is entitled to take independent professional advice as appropriate. The company maintains appropriate directors and officers insurance in respect of legal action against its directors.

The company provides corporate governance training to those directors for whom it is their first appointment to a listed company board, and provides a tailored induction programme for all directors on appointment. The induction programme includes details of board and company policies and procedures, information and briefings by members of management on the company's business and operations, and on laws and regulations particularly applicable to them, and visits to stores, factories, warehouses and other operations. The board is regularly updated on developments relating to the business of the company, corporate governance and other matters of relevance, and non-executive directors attend the company's business conferences and visit the company's operations.

The board's policy concerning the appointment of executive directors to be non-executive directors of other companies is that the additional experience and knowledge such an appointment brings benefits the company, and accordingly, executive directors are permitted to accept one such appointment where no conflict of interest arises, and to retain the fees received.

All non-executive directors disclosed to the board prior to appointment their significant other commitments, and they are required to notify and have notified any changes to or additional commitments from time to time. Sir Nigel Rudd is non-executive chairman of Pilkington and of Pendragon, and during the year was appointed non-executive deputy chairman of Barclays. The board is satisfied that Sir Nigel meets his obligations to the company.

The Senior Independent Director is available to shareholders if they have concerns which contact through the normal channels of Chairman, chief executive or chief financial officer have failed to resolve, or for which such contact is inappropriate.

The company secretary is an employee of the company and is secretary of all board committees, and fulfils the responsibilities required of him by the Combined Code.

### Board committees

There are four principal board committees, all of which operate within written terms of reference. Summaries of the terms of reference and details of the membership of committees are set out below. Copies of the terms of reference are available from the company secretary and on the company's website. Only members of each committee are entitled to attend the meetings of committees, although each committee may invite other directors, managers and advisors to attend and frequently do so. Membership of board committees is regularly reviewed; given the size of the board and the need to have a quorum available, if necessary, at short notice, there is inevitably an overlap in directors' membership of committees, and in particular the board believes it appropriate for all the non-executive directors to be given the opportunity to participate in the work of the nominations committee. However, the chairman of the remuneration committee does not serve on the audit committee, and vice versa, and the board is satisfied that no one director exercises a disproportionate influence. No director has served on any committee for six years or more. Attendance at meetings of committees is set out on page 28.

### Board nominations committee

Directors who served on the committee during the year are as follows:

Sir Nigel Rudd (chairman)	T C Parker
J Bennink	H Ploix
G N Dawson	Dr M P Read

The board nominations committee meets as dictated by circumstances and met once during the year.

The main responsibilities of the board nominations committee are to:

- > Review regularly the structure, size and composition of the board and make recommendations to the board concerning that.
- > Give full consideration to succession planning for directors.
- > Evaluate the balance of skills, knowledge and experience of the board.
- > Prepare a description of the role and capabilities required for any particular board appointment including that of the Chairman.
- > Identify and nominate for the approval by the board candidates to fill board vacancies as and when they arise.

The committee also makes recommendations to the board concerning the standing for reappointment of directors.

During the year under review, the committee recommended that directors standing for reappointment should do so. Since the year end the committee has set in hand a process for recruiting a successor to Mr Dodd who announced in March his intention to resign and has also commenced the process of defining the desired capabilities, background and experience of a further non-executive director given the current balance of skills knowledge and experience on the board.

### Board audit committee

Directors who served on the committee during the year are as follows:

G N Dawson (chairman, appointed September 2003)  
 J Bennink (appointed September 2001)  
 T C Parker (appointed January 2004)  
 H Ploix (appointed September 2000)

Mr Guy Dawson, the current chairman of the committee, was until 2002 chairman of European Investment Banking at Merrill Lynch and is currently a partner in Tricorn Partners, an independent corporate advisory business, and accordingly has recent and relevant financial experience.

The board audit committee met four times during the year. The agenda for each meeting is pre-planned to ensure that each aspect of the committee's responsibilities is discharged as part of an annual cycle.

The main responsibilities of the board audit committee are to:

- > Monitor the integrity and clarity of the financial information and of the major financial statements of the company, and to review any significant financial reporting issues and judgements those statements contain.
- > Approve the annual external audit plan and to review with the external auditors the nature, scope and results of their audit, and any control issues raised by them.
- > Make recommendations as to the appointment, terms of engagement and remuneration of the external auditors and review any question of their resignation or removal, and to review the effectiveness of the external auditors and their independence.
- > Review the consistency of and any changes to accounting policies, the application of appropriate accounting standards, and the methods used to account for significant or unusual transactions.
- > Approve the internal audit plan, monitor and review the effectiveness and freedom from management interference of the company's internal audit function, and to approve the appointment and removal of the head of that function.
- > Review the company's internal controls and systems and practices for the identification and management of risk.
- > Monitor compliance with the company's policies to prevent illegal and questionable corporate conduct and to review arrangements for 'whistleblowing'.

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The external auditors attend meetings of the committee, other than when their appointment or performance is being reviewed, and the head of the internal audit function, the chief financial officer and members of the finance function attend as appropriate. The committee meets with the auditors in the absence of management at least twice a year.

The external auditors are appointed annually at the annual general meeting. The board audit committee considers the reappointment of the auditors and reports its findings to the board. The board audit committee periodically considers the performance, cost and independence of the external auditors, including a comparison of audit fees with those of other retail and FTSE100 companies and reviews the level of service provided by the audit team throughout the group.

In March 2004 the committee adopted a new policy on the engagement of the auditors to supply non-audit services to ensure that auditor independence is not compromised. The policy identifies three categories of non-audit work. Firstly, work such as systems implementation, full outsourcing and preparation of accounting entries and financial information that the auditors are not to perform as to do so would represent a real threat to independence. Secondly, some audit related and advisory services where work can only be undertaken by the auditors with the approval of the audit committee. This category is sub-divided into those projects that require approval regardless of the fee level, for example, staff secondments and advice on design and implementation of policies and controls, and those projects where approval is required if fees exceed a set limit, such as advice on tax matters, advice on preparation of financial information, due diligence and related advice, preparation of completion accounts and training support. Lastly, projects where the work is clearly audit related and where the auditors are best placed to do it, such as regulatory work and acting as reporting accountants, do not of themselves require approval, but given that the level of non-audit fees may themselves constitute a threat, audit committee approval is required if total fees in this category exceed £0.5m.

The committee monitors the overall level of non audit fees, is satisfied that its policy falls within the requirements of the Auditing Practice Board, and ensures compliance with that policy. The auditors annually confirm their policies on ensuring auditor independence and provide the committee with a report on their own internal quality control procedures.

In addition to discharging the responsibilities described above and its work in connection with the audit and auditors, the committee during the year reviewed the plans to implement International Financial Reporting Standards, and the judgements proposed where alternatives are available, and (in light of the APB Ethical standards issued on 17th December 2004 with which auditors must comply) reviewed the auditor terms and conditions and concluded that they are more than adequate.

### Board remuneration committee

Directors who served on the committee during the year are as follows:

Dr M P Read (chairman)	T C Parker
J Bennink	H Ploix

The board remuneration committee met five times during the year.

The main responsibilities of the committee are to:

- > Determine and review from time to time the framework, broad policy and specific terms for the remuneration and terms and conditions of employment of the Chairman of the board and of executive directors, including the design of targets and payments made under any bonus scheme.
- > Agree any compensation for loss of office of any executive director.
- > Recommend and monitor the level and structure of the remuneration of senior managers.

During the year under review the committee reviewed its advisors and appointed Kepler Associates as advisors to the committee. Assisted by Kepler, the committee reviewed executive directors and executive remuneration, and, after consultation with shareholders, approved proposed new long term incentive plans, which are described in the Directors' Remuneration Report, and will be considered at the company's AGM. The committee also during the year reviewed salaries and allowances, made grants and made awards where appropriate under the Executive Share Option Plan and Long Term Incentive Plan. The committee is currently reviewing executive directors' pension arrangements.

A report on the remuneration of directors appears on pages 32 to 41.

### Board social responsibilities committee

Directors who served on the committee during the year are as follows:

H Ploix (chair)	J Bennink
P Bateman	T C Parker

The board social responsibilities committee met four times during the year. The main responsibility of the board social responsibilities committee is to keep under review and advise the board on the company's policies and practices in the areas of social responsibility, including those relating to health and safety, the environment, diversity and equal opportunities, race relations, employment of the disabled, charitable giving and ethical matters, and the company's values and standards.

During the year, the committee reviewed those matters within its remit, and approved a revised code of conduct for ethical trading and reviewed and monitored performance against agreed targets in the area of social responsibility.

### Investor relations

Communications with shareholders are given a high priority. In addition to the annual and half year results presentations and the annual general meeting, a programme of meetings between institutional shareholders and executive directors or the Chairman is held throughout the year. A summary of the views expressed at these meetings is reported to the board. At each board meeting a report is given on shareholders' and analysts' views, issues (if any) and expectations,

and periodically external consultants attend a meeting of the board and present a report on shareholders concerns and expectations. In addition, each director is provided with copies of reports prepared by analysts and brokers and with press cuttings which are of particular value to the directors not resident in the UK. Non-executive directors are given an opportunity to attend meetings with shareholders, and each non-executive director is prepared to do so.

All members of the board usually attend the annual general meeting. A business presentation is given at the meeting, followed by a question and answer session. The notice of the meeting, together with any related papers, is sent to shareholders at least 20 working days before the meeting, or for those who have elected for electronic communication, notice is given to such shareholders of the availability of documents on the company's website. Shareholders are given the opportunity to vote on each separate issue. Postal proxy votes are counted and the proxy votes lodged are announced after the vote on show of hands on each item. Summary proxy figures are made available in writing at the end of the meeting and are also published on the company's website.

#### **Internal control**

The directors have 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 failing to achieve business objectives. Such a system can, however, provide only reasonable, and not absolute, assurance against material misstatement or loss.

Members of the board have responsibility for monitoring the conduct and operations of individual businesses within the group. This includes the review and approval of business strategies and plans and the setting of key business performance targets. The executive management responsible for each business are accountable for the conduct and performance of their business within the agreed strategies.

Business plans and budgets provide a framework from which performance commitments have been agreed between the chief executive and each business. These commitments incorporate financial and strategic targets against which business performance is monitored. This monitoring includes the examination of and changes to rolling annual and half year forecasts, monthly measurement of actual achievement against key performance targets and plans, and weekly reviews of performance.

The group has clear requirements for the approval and control of expenditure. Strategic investment decisions involving both capital and revenue expenditure are subject to formal detailed appraisal and review according to approval levels set by the board. Operating expenditure is controlled within each business with approval levels for such expenditure being determined by the individual businesses.

Executive management are responsible for the identification, evaluation and management of the significant risks applicable to their areas of business. These risks are assessed on a regular basis and may be associated with a variety of internal or external sources.

Each member of the executive and, where appropriate, other members of management annually complete tailored questionnaires relating to compliance with the group's policies and procedures concerning internal controls within their area of responsibility. Those questionnaires are audited by internal audit and the results presented firstly to the internal audit committee, chaired by the chief executive, and are then reviewed by the board audit committee.

The internal audit function works throughout the group to further develop, improve and embed risk management processes and tools in the business operations. It also provides assurance to the board that risk management practices address the key risks faced by the group including risks that could arise from social, environmental and ethical matters. Its work includes an assessment of the risks and controls throughout the group and its findings are reported to senior management responsible for the area concerned. Internal audit also reports regularly to the board audit committee.

The board audit committee assists the board in fulfilling its oversight responsibilities, reviewing the reporting of financial and non-financial information to shareholders and the audit process, satisfying itself that appropriate systems of internal control and risk management are in place and are serving to identify and manage risk. The external auditors and the head of the internal audit function attend all meetings of the audit committee, save in the case of the external auditor those parts of any meeting when the committee reviews the performance of the auditor.

The group's system of internal control and its effectiveness is monitored and reviewed regularly by the board, the board audit committee, the internal audit function, and management, and the board believes that the company has maintained throughout the year and up to the date of approval of the Annual Report and Accounts an effective embedded system of internal control and has complied with the Turnbull guidance.

#### **Social, environmental and ethical matters**

The company has for many years recognised the benefits that accrue from responsible employment, environmental and community policies which are also described elsewhere in this report. Identifying and managing risks to the company's reputation has been described above and has a high priority. The evaluation of the company's performance in social, environmental, community and ethical matters is ongoing.

#### **Going concern**

Having considered group cash flow forecasts and strategic plans, the directors are satisfied that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.