Corporate governance

Combined Code

The Financial Services Authority ("FSA") requires listed companies to disclose, in relation to the Combined Code ("the Code"), how they have applied its principles and whether they have complied with its provisions throughout the accounting year.

The Board of GUS supports the principles of corporate governance advocated by the Code and, following a change made during the year under review, it is now able to confirm that it fully complies with all its provisions.

The Board's policy over many years has been to limit the service contracts of executive directors to one-year rolling terms and, to this extent, it complies with the relevant provision of the Code. In the past, there has been one exception to this policy which the Board justified as being in shareholders' interests. As a reflection of local employment conditions in South Africa, Alan Smart, Chief Executive of the Group's retailing interests in that country, had a contract which provided for 24 months' notice on the part of both the company and the executive. These arrangements were varied during the course of the year under review in that, by letter dated 21 August 2002, the parties agreed that the period of notice should be reduced to 12 months on the part of both the executive and the company. With this exception, there was full compliance with the provisions of the Code throughout the year under review.

The coming year will see changes to the Code as a result of the publication, in January 2003, of the following reports:-

- The Higgs Review – The Role and Effectiveness of Non-Executive Directors
- The Smith Report – Combined Code Guidance for Audit Committees

The new Code was to have applied to reporting periods beginning on or after 1 July 2003 and it was generally expected that full compliance with the new provisions of the Code would take some time for companies to achieve. However, implementation has now been deferred to provide an opportunity for a working party to consider the proposals further. The Board of GUS will be considering these in full once the new Code has been published.

In the meantime, the Board has taken the opportunity to improve its practices by adopting some of the recommendations of the two reports.

Directors

The Board consists of a Chairman, a Chief Executive plus four executive directors and five non-executive directors. Sir Alan Rudge is the senior independent member of the Board.

The five non-executive directors are determined by the Board to be independent in character and judgement and there are no relationships or circumstances which could affect, or appear to affect, a director's judgement. The Higgs Review has recommended a definition of independence for inclusion in the revised Code. Under this definition, Lord Harris will be deemed not to be independent because he has served on the Board for more than ten years; a position previously recognised by the Company in his standing down as a member of the Remuneration Committee. In the light of his length of service, Lord Harris will now be subject to annual re-election by shareholders.

The non-executive directors are appointed for specified terms, the details of their respective appointments being as set out in the Report on Directors' Remuneration and Related Matters on page 49.

The Chairman and the non-executive directors meet as a group without the executive directors present and the non-executive directors would consider meeting in the absence of the Chairman if there were concerns which the Chairman had failed to resolve or if there were any issues concerning his performance or terms of appointment.

The Board has six scheduled meetings each year and meets more frequently as required. It met on ten occasions during the year under review.

The duties of the Board and its committees are set out clearly in formal terms of reference, which are reviewed regularly, stating the items specifically reserved for decision by the Board. The Board establishes overall Group strategy, including new activities and withdrawal from existing activities. It approves the Group's commercial strategy and the operating budget and monitors divisional performance through the receipt of monthly reports and management accounts. The process for the approval of acquisitions/divestments for the most part is a matter reserved for the Board save that it delegates to the Chief Executive the responsibility for such activities up to a specified level of authority. Similarly there are authority levels covering capital expenditure which can be exercised by the Chief Executive or by the Chairman and Chief Executive jointly. Beyond these levels of authority, projects are referred to the Board for approval.

Other matters reserved to the Board include:-

- Treasury
- Control, audit and risk management
- Remuneration
  – the Company's framework of executive remuneration and its cost in the light of recommendations made by the Remuneration Committee

  – the remuneration of the non-executive directors
- Pension schemes
- Corporate Social Responsibility
- The appointment or removal of the Company Secretary

The Board is supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. This includes monthly management accounts irrespective of whether or not a Board meeting is programmed. There is also a procedure under which directors, in furtherance of their duties, are able to take professional advice, if necessary, at the Company's expense. The Company Secretary is responsible for ensuring that Board procedures are followed and all directors have access to his advice and services.

Hitherto, there has been no formal process covering performance evaluation of the Board. However, this is a matter that has received the attention of the Board and such a process has been introduced during the course of the current financial year.

All directors are subject to re-election by shareholders at the first opportunity after their appointment and thereafter in accordance with Article 76.1 of the Company's Articles of Association. This ensures compliance with the Code by providing that all directors are required to submit themselves for re-election at least once every three years.

The Board has established a number of committees, including Audit, Remuneration, Nomination and Corporate Governance:

(a) Audit Committee

The Audit Committee consists of four non-executive directors, considered by the Board to be independent. They are Oliver Stocken (Chairman), Frank Newman, Lady Patten and Sir Alan Rudge. The Committee has at least one member possessing what the Smith Report describes as recent and relevant experience. Oliver Stocken, a chartered accountant, was Group Finance Director of Barclays PLC between 1993 and 1999. It will be seen from the directors' biographical details, appearing on pages 30 and 31, that the other members of the Committee bring to it a wide range of experience from positions at the highest level both in the UK and the USA.

The Committee normally meets four times a year and did so during the year under review. Both the external auditors and the Group Internal Auditor are present at the meetings and, in addition, it is common practice for the Committee to meet the external auditors without management present.

The main role and responsibilities are set out in written terms of reference which encompass those recommended by the Smith Report for adoption in a revised Combined Code, ie:-

- to monitor the integrity of the financial statements of the Company, reviewing significant financial reporting issues and judgements contained therein;
- to review the Company's financial control and risk management systems;
- to monitor and review the effectiveness of the Company's internal audit function;
- to make recommendations to the Board in relation to the appointment of the external auditor and to approve the remuneration and terms of engagement of the external auditor; and
- to monitor and review the external auditors' independence, objectivity and effectiveness, taking into account UK professional and regulatory requirements.

These responsibilities are discharged in the following manner:-

- At its meetings in May and November, the focus falls on a review of the Preliminary Announcement/Annual Report and Financial Statements, and the Interim Announcement respectively. On both occasions, the Committee receives reports from the external auditors identifying any accounting or judgemental issues requiring its attention.
- A quarterly report from the Group Internal Auditor is presented at each of the four meetings. In addition, at the March meeting, the Group Internal Auditor submits the department's audit plans for the coming year.
- The external auditors also present their audit plans at the March meeting and, at the September meeting, there is a detailed review of the management letter covering the auditors' findings in respect of the prior financial year.
- Group companies are, from time to time, required to make presentations to the Committee on the subject of risk, its identification, management and control.
- As a matter of routine, the Committee is presented with information on material litigation involving Group companies.

As noted above, one of the duties of the Audit Committee is to make recommendations to the Board in relation to the appointment of the external auditors. A number of factors are taken into account by the Committee in assessing whether to recommend the auditors for re-appointment. These include:-

- The quality of reports provided to the Audit Committee and the Board and the quality of advice given.
- The level of understanding demonstrated of the Group's business and industry.
- The objectivity of the auditors' views on the controls around the Group and their ability to co-ordinate a global audit working to tight deadlines.

The Committee has put in place safeguards to ensure that the independence of the audit is not compromised. In this context, the Committee receives half yearly reports providing details of assignments and related fees, carried out by the external auditors in addition to their normal work. These are reviewed against the Committee's established guidelines which are:-

- Audit related services – the auditors' deep knowledge of the Group's affairs means that they are best placed to carry out such work. This extends to, but is not restricted to, shareholder and other circulars, regulatory reports and, on occasion, work in connection with acquisitions and disposals.
- Taxation services – generally, the auditors' knowledge of the Group's affairs provides significant advantages which other parties would not have. Where this is not the case the work is put out to tender.
- General – in other circumstances, proposed assignments are put out to competitive tender and decisions to award work taken on the basis of demonstrable competence and cost-effectiveness.

(b) Remuneration Committee

The Remuneration Committee consists exclusively of non-executive directors considered by the Board to be independent : Lady Patten (Chairman), Sir Alan Rudge and Oliver Stocken. The application of corporate governance principles in relation to directors' remuneration is described in the Report on Directors' Remuneration and Related Matters on pages 41 to 50.

(c) Nomination Committee

The members of the Nomination Committee are Sir Victor Blank (Chairman), the five non-executive directors and John Peace. The Committee would be chaired by the senior independent director on any matter concerning the chairmanship of the Company.

The Nomination Committee has written terms of reference covering the authority delegated to it by the Board. These include the following duties:-

- To review regularly the Board performance, including structure, size and composition and make recommendations to the Board with regard to any adjustments that are deemed necessary.
- Board appointments and removals are matters reserved for the Board. It is the responsibility of the Nomination Committee to identify and nominate candidates, for the approval of the Board, to fill Board vacancies as and when they arise and to review succession plans for both Board and senior executive positions.
- Setting policy for granting of service agreements (including mitigation policy).

(d) Corporate Governance Committee

The members of the newly constituted Corporate Governance Committee are Sir Victor Blank, John Peace, Sir Alan Rudge and David Morris, the Company Secretary.

The Committee has written terms of reference covering the authority delegated to it by the Board. These include keeping under review all legislative, regulatory and corporate governance developments that might affect the Company's operations and making recommendations to the Board in relation thereto, always striving to ensure that the Company is at the forefront of best practice.

Relations with shareholders

The Company recognises the importance of communicating with its shareholders and does this through its Annual and Interim Reports and at the Annual General Meeting. Although it does not have precise rules covering meetings with institutional shareholders, it is always ready to enter a dialogue with investors, and meetings take place frequently.

The Board is also keen to have an independent insight into the views of major investors and, with this in mind, it commissions its external Investor Relations adviser to carry out research in interviews with such shareholders. A detailed report is then prepared and its findings are presented to the Board. Any investor with concerns should take these to the Chairman and, if unresolved, to the senior independent director.

All directors normally attend the Annual General Meeting and are available to answer shareholders' questions. Voting at the Annual General Meeting is by way of a show of hands by members present at the meeting unless a poll is validly called. Following each vote on a show of hands, the level of proxies lodged on each resolution and the number of proxy votes for and against the resolution is announced.

Corporate Social Responsibility

The case to demonstrate corporate social responsibility continues to grow as do requests for engagement meetings on the subject from institutional investors, the Government, non-governmental organisations and the media.

Last year we published our first CSR report and were encouraged by the feedback we received from shareholders and interested parties. This year we have adopted a different approach by publishing the report on the GUS website instead of in hard copy form. A briefer, printed version will be available, on request, from the Company Secretary's Office.

A growing number of mainstream City institutions has decided to incorporate social responsibility into corporate governance frameworks. They view CSR in the context of risks and opportunities and their impact on shareholder value. Accordingly, these major institutions want assurance that companies they invest in are fully aware of the risks and have effective management systems to deal with them.

The Association of British Insurers ("ABI") has responded to this pressure from its members by developing a set of guidelines, in the form of disclosures which institutions would expect to see included in the annual reports of listed companies. Specifically they refer to disclosures relating to Board responsibilities and to policies, procedures and verification. The guidelines refer to social, ethical and environmental matters ("SEE") and do not use the term CSR.

The GUS disclosures are as follows:-

(a) With regard to the Board

- The Board takes regular account of the significance of social, environmental and ethical matters to the businesses of the Company. The responsibility for such matters lies with the Company Secretary who ensures that they feature regularly on the Board agenda. He is supported in this work by a CSR Committee which meets under his chairmanship and which draws on staff with relevant expertise from across all of the Group's businesses. It includes experts in communication, internal audit, community affairs, consumer rights and environment. It is supported by external advisers.

- The section on internal control, which appears below, includes, inter alia, the Board's confirmation that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. This process includes the identification and assessment of the significant risks to the Company's short and long term value arising from SEE matters, as well as the opportunities to enhance value that may arise from an appropriate response.

- The Board receives adequate information to make this assessment and, in this context, reference should be made to the key procedures described below under internal control. Account is taken of SEE matters in any training programmes deemed appropriate on the appointment of new directors.

(b) With regard to policies, procedures and verification

- The Board has identified supply chain issues as an area of potential risk that might significantly affect the Company's short and long term value. GUS has significant buying power, giving it some degree of responsibility for the actions of the companies with which it deals. As GUS takes seriously its own social responsibility, it is only natural that it should want those over whom it has influence to do the same and, in so doing, guard against the risk to its reputation through a potential association with undesirable practices. To this end the Board has approved a set of seven principles that merchandise suppliers and business partners will be asked to endorse. These are set out in more detail in the CSR Report referred to earlier.

- Practice to comply with these principles varies by division. In summary:-

  – A Burberry Supplier Code of Conduct has been developed which has been sent to all suppliers of finished goods in the international product range, with all being required to comply. The finished goods supply base and licensee network has been evaluated in conjunction with third party consultants, with the aim of identifying those products and countries posing the greatest environmental and social concerns. During the year, a pilot audit was carried out at 24 manufacturing sites of suppliers, major licensees and their sub-contractors with the aim of identifying and subsequently managing issues around social, ethical and environmental standards. The audit programme is continuing in the year ending 31 March 2004.

  – The principles have been incorporated into the standard supply contracts for merchandise suppliers in ARG. A programme of third-party audits is well established for manufacturers of all Argos directly-imported goods. In addition this programme was extended to suppliers of ARG Equation. All major suppliers of non-merchandise products and services (predominantly UK-based companies) have been formally notified of the principles by letter.

  – The programme in Experian UK focuses primarily on the environmental performance of the suppliers in support of Experian's commitment to obtaining the environmental accreditation ISO14001. This supply base presents a much lower risk of social and labour concerns.

- The Company's policies and procedures for managing risks to short and long term value arising from SEE matters are as described below under "Internal Control".

- An important aspect of the Company's SEE procedures is that they should be subject to verification and this is reflected in the Group Internal Auditor's membership of the CSR Committee. However, it is felt that shareholders would welcome some measure of external verification and the procedures for verification of SEE disclosures are focused on work undertaken by Acona, an independent consultancy practice. This involves a review which has four principal aspects:-

  – Ensuring that GUS has identified the SEE issues relevant to its business.

  – Examining the policies and frameworks for managing these issues.

  – Confirming that data collection systems are comprehensive and examining the data for completeness and accuracy.

  – Verifying that all claims in the report can be supported by evidence.

Accountability and Audit

It is a requirement of the Code that the Board should present a balanced and understandable assessment of the Company's position and prospects. In this context, reference should be made to the Statement of Directors' Responsibilities on page 40, which includes a statement in compliance with the Code regarding the Group's status as a going concern, and to the Report of the Auditors on page 53, which includes a statement by the auditors about their reporting responsibilities.

The Board recognises that its responsibility to present a balanced and understandable assessment extends to interim and other price sensitive public reports and reports to regulators as well as information required to be presented by law.

Internal Control

The Board acknowledges that it is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide reasonable, but not absolute, assurance against material mis-statement or loss. The Board has reviewed the effectiveness of the key procedures which have been established to provide internal control.

Following publication of guidance for directors on internal control (The Turnbull Guidance) the Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. These include those relating to social, environmental and ethical matters. This process was in place throughout the year under review and up to the date of approval of the Annual Report with the exception of Homebase, acquired in December 2002, where the process is under review. The process is regularly reviewed by the Audit Committee, which reports its findings for consideration by the Board, and is in accordance with The Turnbull Guidance.

The key procedures, which operated throughout the year, are as follows:-

- Risk assessment:
  - The Group clearly sets out its objectives as part of its medium term planning process. These objectives are then incorporated as part of the budgeting and planning cycle and are supported by the use of both financial and non-financial key performance indicators.
  - The operating divisions are required to make presentations on risk to the Audit Committee which reports regularly to the Group Board on the risks facing the businesses.
  - The detailed assessment of strategic risks is delegated to the Group Chief Executive. This review is carried out as part of the annual budgeting and the monthly reporting and re-forecasting cycles.
  - The Audit Committee has delegated responsibility for considering operational, financial and compliance risks on a regular basis and receives reports on the controls over these risks biannually. This includes risks arising from social, environmental and ethical matters.
- Control environment and control activities:
  - The Group consists of a number of major trading divisions each with its own management and control structures.
  - The Group has established procedures for delegated authority which ensure that decisions that are significant, either because of the value or the impact on other parts of the Group, are taken at an appropriate level.
  - The Group has implemented appropriate strategies to deal with each significant risk that has been identified. These strategies include not only internal controls but other approaches such as insurance, joint ventures and specialised treasury instruments.
  - The divisions operate within a framework of policies and procedures laid down in organisation and authority manuals, and personnel are required to comply with these procedures. Policies and procedures cover key issues such as authorisation levels, segregation of duties, compliance with legislation and physical and data security.
- Information and communication:
  - The Group has a comprehensive system of budgetary control including monthly performance reviews for each major business and division. These reviews are at a detailed level within the trading divisions and at a high level for the Group Board.
  - On a monthly basis, the achievement of business objectives, both financial and non-financial, is assessed using a range of key performance indicators. These indicators are reviewed to ensure that they remain relevant and reliable.
  - There are clear procedures in the major trading divisions for employees to report suspected improprieties.
- Monitoring:
  - A range of procedures is used to monitor the effective application of internal control in the Group including control self-assessment, management confirmation of compliance with standards and internal audit reviews.
  - The internal audit department's responsibilities include reporting to the Audit Committee on the effectiveness of internal control systems focusing on those areas of greatest financial risk to the Group.
  - Follow-up procedures ensure there is an appropriate response to changes in risks and controls.