

# Audit Committee report

This Report has been prepared in accordance with the requirements of paragraph C.3.3 of the Combined Code and paragraphs 5.1 and 5.2 of the Guidance on Audit Committees produced by Sir Robert Smith. The report describes the role of the Audit Committee in meeting these requirements.

## Terms of reference

The Committee's terms of reference, a copy of which can be found in the Responsibilities – Governance area on the Company's website, are reviewed from time to time and approved by the Board. They are based on the model terms of reference set out in the Guidance Note produced by the Institute of Chartered Secretaries and Administrators and take account of the requirements of Sarbanes-Oxley and the Guidance Notes set out in Sir Robert Smith's Report published in January 2003.

The terms of reference cover membership and appointment, meetings, duties and responsibilities, authority and a number of other matters. The Companies Act 2006 imposed new duties on Directors to avoid a conflict of interests, particularly in relation to third-party arrangements and, during the year, the Board delegated to the Audit Committee the duty of looking at each Director in turn and examining any possible sources of potential conflict. This duty was incorporated into the Audit Committee's terms of reference in July 2008. No conflicts were found to exist.

## Membership and appointment

The Audit Committee comprises four independent Non-Executive Directors: David Richardson who was appointed to the Committee in March 2006 and became Chairman in May 2006, Richard Gillingwater who was appointed in December 2005, John McDonough and Leo Quinn who were appointed in July 2007.

The Board has determined that all four members of the Audit Committee are independent for the purposes of the Combined Code and rule 10A.3(b)(1) under the Exchange Act and section 303A of the NYSE's Listed Company Manual. The members bring wide-ranging financial, commercial and management experience to the work of the Audit Committee.

The Chairman of the Committee, David Richardson, is a Chartered Accountant (FCA), having previously held a number of senior financial management and strategic planning positions in Whitbread plc from 1983 to 2005 (in the UK and US), becoming Group Finance Director in 2001. Prior to 1983, he held financial positions in ICL plc and Touche Ross & Co. In accordance with section 407 of Sarbanes-Oxley, the Board has determined that David Richardson is an 'audit committee financial expert' as that term is defined under the rules of the SEC, having significant, relevant and up-to-date UK and US financial and accounting knowledge and experience.

## Meetings

The Audit Committee meets at least four times a year and on other occasions when circumstances require. The quorum for a meeting of the Committee is two members. The Finance Director and representatives from the independent auditor and the internal auditor attend meetings under a standing invitation. The Chairman of the Board, the CEO and other Directors are able to attend meetings of the Committee under the practice that any Director may attend any meeting of a Committee of the Board, provided that they have no conflict of interest in respect of business to be discussed. It is usual practice for the CEO to attend meetings of the Audit Committee. Other finance and business risk executives attend meetings and the Company Secretary is Secretary to the Committee. The Committee Chairman reports regularly to the Board on its activities. Four meetings were held during the year and attendance is set out in the table on page 43.

## Work of the Committee

The Committee has established an 'agenda framework' which the Company considers vital for maintaining an appropriate focus on the objectives of the Committee. The agenda sets out all of the operational duties and responsibilities outlined in the Committee's terms of reference and is based on four regular meetings, in February, April, July and November, which coincide with the interim management statements and the announcement of results. The areas covered by the 'agenda framework' are as follows:

1. Corporate Governance, including the regular review of the Committee's terms of reference and annual evaluation, regulatory issues, review of delegated authorities and review of auditor independence.
2. Internal Audit, including the review of the internal audit charter, internal audit review reports on the Group's internal control and risk assessment processes, compliance with auditing standards and progress against its internal audit plan, functional developments and key performance measures.
3. Confidential sessions with the independent auditors and the Vice-President, Internal Audit, in the absence of Directors and Company executives.
4. Financial Reporting, including current accounting and financial reporting matters and review of half-yearly and annual financial statements prior to their submission to the Board for approval, which includes the consistency of judgements adopted.
5. Independent Auditors, including appointment, audit plan and scope, review of audit fees, cost effectiveness, approval of non-audit fees, reports on half-yearly and annual financial statements and the effectiveness of internal controls over financial reporting, status reports, management letters and the nature and extent of non-audit services.

The audit plan and scope sets out details of the areas to be covered and how the audit is to be conducted. The Chairman of the Audit Committee meets periodically with the independent auditors to discuss progress on the audit and the major points to arise, and has the opportunity to assess the effectiveness of the process. The Committee is also able to assess the effectiveness of the auditors and the process through reports made by the independent auditors.

In addition to the items considered by the Committee under the 'agenda framework', during 2008 other important issues considered included a review of the change of the Company's functional currency and the Group's presentation currency from sterling to the US dollar, periodic reporting under the Disclosure and Transparency Rules of the UKLA, a review of the top ten required financial controls and an update of the Committee's terms of reference to deal with changes brought about by the Companies Act 2006. The Committee also undertook regular reviews of the internal control systems and the statement to be made in the Directors' Report in respect of internal controls, the Group risk profile, Group tax reports, updates on compliance with the Combined Code and approval of Form 20-F. The Committee received reports on the Company's efforts in countering potential fraud in the Group. The Internal Audit function is actively engaged in assessing the adequacy and effectiveness of the Group's system of internal control and risk management processes. Each quarter, the Committee receives a summary of reviews of the businesses' risk management processes and any significant related financial exposures are highlighted. The risk assessment process and risk mitigation plans are an important part of the development of business strategies. Business risks are considered at the quarterly reviews with the businesses, where all of the major strategic, operational, compliance and financial risks are discussed. Confidential meetings with representatives of the independent auditors and internal audit functions took place during the year in the absence of executives.

In determining its policy on the extent of non-audit services provided by the independent auditors, the Committee has taken account of the rules of the SEC which regulate and, in certain circumstances, prohibit the provision of, certain types of non-audit services by the independent auditors. Non-audit services require the approval of the Chairman of the Audit Committee. During the year, certain projects requiring tax services were awarded to the firm of the independent auditors. In those cases where the work was awarded to the independent auditors, it was concluded that the firm of the independent auditors was best placed to supply such tax services in a cost-effective manner due to the experience and qualifications of the individuals providing such services, the independent auditors' knowledge of the Company and its tax affairs and that the best interests of the Company were served by engaging the firm of the independent auditors. The previous adoption of certain other rules by the Committee, including those relating to audit partner rotation, relevant ethical guidance regarding the provision of non-audit services by the independent auditors (in particular that the independent auditors should not audit their own firm's work, make management decisions for the Company, create a mutuality of interest nor be put in the position of advocate for the Company), when taken together provide adequate protection of auditor independence. All fees proposed by the independent auditors must be reported to and approved by the Audit Committee or, between meetings, the Chairman of the Audit Committee. Details of audit fees for the year can be found in note 17 to the Group's consolidated financial statements.

The Company's practice, in accordance with UK company law and the Combined Code, in relation to the appointment and termination of the independent auditors, involves a recommendation from the Audit Committee to the Board, which will then make a recommendation to shareholders in general meeting. This differs from the procedure in the US, where the independent auditors are accountable to the Audit Committee which has the authority to appoint or dismiss the independent auditors without reference to shareholders.

With the approval of the Board, the Committee has established guidelines for the recruitment of employees or former employees of the independent auditors. The Group will not engage, on a part-time or full-time basis, any person who is or was an employee of the Company's independent auditors, where that person has worked on the Group's audit either as a principal or partner at any time during a period of not less than three years prior to the proposed date of joining the Group. Certain less stringent conditions apply to other employees or former employees of the independent auditors.

A 'whistleblowing' procedure has been established for the confidential and anonymous submission by employees of concerns regarding accounting, internal controls or auditing matters, in accordance with the requirements of section 301 of Sarbanes-Oxley. Should a call be received on the dedicated telephone line, the Company Secretary or the General Counsel would immediately report to the appropriate management all concerns raised. A course of action is agreed and a report is prepared for review at the next meeting of the Audit Committee, including details of actions taken to deal with the matters raised where the significance of the event warrants such an action. The Chairman of the Committee will report, if appropriate, whistleblowing claims to the Committee and the Board. The Company's Code of Conduct and Ethics includes the whistleblowing procedure. Calls to the designated telephone number, as well as direct contacts with management, are made from time to time, but no whistleblowing issues material to the Company were dealt with by the Committee during the year.

Shareholders are given the opportunity at the AGM to ask the Chairman of the Committee questions on this report and any other related matter.

**David Richardson**  
Chairman, Audit Committee

24 February 2009