

Report of the Directors – Corporate Governance Report

This Corporate Governance Report describes the manner in which the Company has applied the Principles of Good Governance set out in Section 1 of the Combined Code on Corporate Governance and whether or not it has complied with the Code provisions.

In July 2003, the Financial Reporting Council issued the "Combined Code on Corporate Governance" known as the "2003 FRC Code", in response to the Higgs Review on Non-Executive Directors and the Smith Review on Audit Committees.

Application of the Principles

The Principles of Good Corporate Governance are detailed in the 2003 FRC Code under four areas which have each been reviewed by the Directors and then commented upon below:

a) Directors

The Board is structured under a non-executive Chairman and currently includes three executive Directors and two other non-executive independent Directors who were selected for appointment because of their wide industrial and commercial experience. In addition, there is a Group Executive Committee, chaired by the Chief Executive which includes, along with the executive Directors, other key executives within the Group. Brief details of the Board are included on page 8.

The Directors consider that there is in place an effective Board which leads and controls the Group with clear divisions of responsibility between running the Board and running the Group's business. The Board is responsible for the strategic decisions regarding the Group, including the setting of the commercial strategy and approval of Group budgets and financial statements. It also approves significant financial and contractual commitments made by the Group. The Board's terms of reference more fully describe the responsibilities of the Board and may be found on the Company's website.

The Board delegates certain of its responsibilities to the Audit, Remuneration and Nominations Committees. The Chief Executive, together with the Group Executive Committee, is responsible for the implementation of the decisions made by the Board and for the day-to-day conduct of the Group's operations.

The Board meets formally on a regular basis (ten times in 2004) and in addition there were three meetings of the Audit Committee in 2004, together with three meetings of the Remuneration Committee and two meetings of the Nominations Committee. Other Committees are appointed by the Board to deal with treasury matters and specific issues such as acquisitions and disposals. The minutes arising from the Committee Meetings are available to the Board.

Procedures are in place to ensure that the Directors are properly briefed so that the decisions taken by the Board are based on the fullest available information. At every Board Meeting there are reviews of operational, financial and administrative matters while social, environmental and ethical issues and other matters such as health and safety, agreement of budgets and levels of insurance cover are reviewed whenever appropriate.

There is a procedure by which all Directors can obtain independent professional advice at the Company's expense in furtherance of their duties, if required.

Nominations Committee

The Nominations Committee leads the process for Board appointments and supervises management development and succession plans. It makes recommendations to the Board on all new Board appointments. The Committee, which consists entirely of non-executive Directors, is chaired by J R Kerr-Muir and its composition is shown on page 8. Its terms of reference may be found on the Company's website.

The appointment of new non-executive Directors to the Board is controlled by the Committee and assisted by appropriate external recruitment consultants. In conjunction with the external consultant, consideration is given to the role and the capabilities required for a particular appointment. Based on agreed criteria, the consultant then produces a shortlist of candidates. The Committee members interview these candidates then present their recommendation to the Board. G A Campbell was appointed to the Board during the year. The Nominations Committee followed the above procedures and determined that he was the best candidate for the post, and would complement the skills, knowledge and experience of the other Directors.

During the year, the Board undertook a formal performance evaluation process to evaluate its own performance and that of its committees and individual Directors, which involved the completion and review of performance assessment questionnaires, and appraisal interviews. The results of the evaluation process are used to improve Board performance and determine the training needs of the Directors. M Clark and R T Turner, in consultation with the executive Directors, undertook an evaluation of the Chairman's performance and concluded that J R Kerr-Muir continued to provide effective leadership of the Board. Based on the results of the performance evaluation process, the Chairman considers that each member of the Board, the Board collectively and its Committees continue to contribute effectively to the running of the Company.

In accordance with the Company's Articles, Directors submit themselves for re-election at the Annual General Meeting following their appointment and thereafter at intervals of no more than three years.

b) Directors' Remuneration

The Report of the Directors – Remuneration Report on pages 11 to 15 describes how the Board has applied itself to remuneration matters.

c) Accountability and Audit

This section of the Report of the Directors describes the role of the Audit Committee and the manner in which it discharges its responsibilities. The Audit Committee's terms of reference may be found on the Company's website.

Composition of the Audit Committee

The composition of the Audit Committee, which consists entirely of non-executive Directors, is detailed on page 8. During 2004, the Audit Committee did not comply with all the recommendations of the Smith Guidance as appended to the 2003 FRC Code, in that the Chairman, J R Kerr-Muir, was a member. As the Company has only three non-executive Directors, the Board considered it appropriate for J R Kerr-Muir to remain a member of the Audit Committee during the period of transition that arose from the retirement of R T Turner in 2004. J R Kerr-Muir subsequently retired from the Audit Committee on 24 December 2004.

Financial Reporting

The Board believes that the Annual Report properly presents a balanced and understandable assessment of the Group's position and prospects. The Audit Committee monitors the half year and full year annual financial statement before submission to the Board, as well as any formal announcements relating to the Group's financial position.

There is an independent internal audit function, which includes a cyclical programme of visits to all Group operations. The Group Internal Audit function also co-ordinates semi-annual Financial Integrity Declarations and self-assessment questionnaires which are applied on a cyclical basis and subjected to review. The results of these reviews and internal audit visits are reported to the Audit Committee, along with those from the external auditors.

The Audit Committee reviews the scope, cost and timing of the work of the external auditors and acts to ensure their findings are appropriately implemented. Whilst the Company does not have a policy of subjecting its external auditors to a regular fixed term rotation, the Committee remains cognisant of the importance of maintaining the objectivity of the Company's 2004 external auditors. The Committee also reviews the level and type of non-audit work carried out by the Company's external auditors. In 2004 £0.4m was paid in fees to the external auditors relating to non-audit work, principally for advice on tax compliance (£0.3m) and taxation consulting services (£0.1m). The Committee considers it is beneficial to the Company to retain Deloitte & Touche LLP for this type of work because of their expertise in this area and knowledge of the Group, however, the Committee will continue to keep the nature and extent of such services under review in order to balance the maintenance of objectivity and value for money.

Internal Control

The Company has a well-established and ongoing process, which was in place for the full year and up to the date of the Accounts, for identifying, evaluating and managing the significant risks, including non-financial risks, faced by the Group. This process is regularly reviewed by the Board and has been further improved during the year. The process continues to accord with the Turnbull guidance on internal control.

Information on the Group's significant risks, together with the relevant control and monitoring procedures, is reviewed for completeness and accuracy by the Group's management committees. The information is presented to the Board for it to assess the effectiveness of the system of internal control. Whilst the Board acknowledges its overall responsibility for internal control it believes strongly that senior management within the Group's operating businesses should contribute in a substantial way and this has been built into the process.

In carrying out their review of the effectiveness of internal control in the Group the Board has taken into consideration the following key features of the risk management process and system of internal control:

- Senior management of each business have spent time identifying and assessing business unit and Group objectives, key issues, opportunities and controls. This assessment encompassed operational, compliance, financial and business risks and is updated on an ongoing basis. A risk assessment has similarly been prepared for the Group covering central functions and strategic risks;
- A detailed system of budgeting, reporting and forecasting for the Group's operations is in place which is monitored, both locally and centrally, through a review of monthly management information;
- The Group has expanded the remit of the Internal Audit function whose audit plan is reviewed, updated and approved by the Audit Committee. The conclusions from the function's work are reported to the Audit Committee, the Chief Executive and the Finance Director; and
- There is in place a formal annual risk management sign-off process for senior management in each of the business units. This is operated in order to ensure that, as far as possible, the controls and safeguards are being operated in line with established procedures and standards.

The whole risk management process is subject to review twice a year by the Audit Committee and strengthened as appropriate. Steps are taken to embed internal controls and risk management further into the operations of the business and to deal with areas of improvement which come to management's and the Board's attention. The Board is responsible for the effectiveness of the Group's system of internal control and for the review of its effectiveness. Such a system is designed to manage rather than to eliminate the risk of failure to achieve the Group's objectives and can only provide reasonable but not absolute assurance against misstatement or loss.

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d) Relations with Shareholders

The Company maintains regular contact with its institutional shareholders. Each year, the Chief Executive and Finance Director undertake a series of meetings with the Company's major shareholders, following the announcement of the full year and interim results, to discuss both strategic objectives and the detailed performance of the business. During 2004, J R Kerr-Muir, the Company's non-executive Chairman and M Clark, the Company's Senior Independent Director also attended the full year and interim results announcements to shareholders and analysts in March and August respectively. No other non-executive Director formally met with shareholders during the year. M Clark is available to attend shareholder meetings if this is requested by shareholders, so providing an alternative channel of communication between the Company and its shareholders. The Company's largest shareholders were invited to meet G A Campbell following his appointment as a non-executive Director in 2004. The Company consulted with its largest shareholders prior to finalising the proposed executive long term incentive plan which is to be presented for shareholder approval at the 2005 AGM.

The Company makes constructive use of the Annual General Meeting to communicate with private investors. A detailed presentation of the Company's performance is given at the AGM and a copy of the presentation, along with other investor relations material, is made available on the Company's website.

All resolutions at the 2004 AGM were passed unanimously on a show of hands. Details of the proxy voting received by the Company for the 2004 AGM are set out in the table below.

Proxy voting for the 2004 AGM

| Resolution | For (votes) | Against (votes) | Discretionary (votes) | Abstentions (votes) | Total (votes) |
|--|----------------|--------------------|--------------------------|------------------------|------------------|
| 1. To adopt Report & Accounts | 213,476,066 | 2,143 | 163,063 | 35,800 | 213,677,072 |
| 2. To approve Remuneration Report | 198,145,060 | 592,029 | 169,060 | 14,770,923 | 213,677,072 |
| 3. To declare a dividend | 213,457,931 | 14,228 | 160,313 | 44,600 | 213,677,072 |
| 4. To re-elect J R Kerr-Muir as a Director | 213,137,779 | 330,505 | 171,356 | 37,432 | 213,677,072 |
| 5. To re-elect M Rollins as a Director | 213,150,398 | 317,886 | 171,356 | 37,432 | 213,677,072 |
| 6. To re-appoint Deloitte & Touche LLP as auditors | 213,029,310 | 279,283 | 168,974 | 199,505 | 213,677,072 |
| 7. Authority to allot shares | 213,352,541 | 109,215 | 171,453 | 43,863 | 213,677,072 |
| 8. Disapplication of pre-emption rights | 213,142,846 | 309,703 | 173,660 | 50,863 | 213,677,072 |
| 9. Authority to buy back shares | 213,409,244 | 60,568 | 172,660 | 34,600 | 213,677,072 |

The abstentions to Resolution 2 approving the Remuneration Report came from 25 shareholders. More than three-quarters of the abstention votes came from a single shareholder due to re-testing being permitted for existing share options and the use of EPS-based performance criteria for the options. The Senior plc 2005 Long Term Incentive Plan that is to be presented to shareholders for approval at the forthcoming AGM (if approved, it will replace the existing 1999 Executive Share Option Plan and the Long Term Share Incentive Plan) will have performance criteria that are both EPS and TSR-based, and the awards will not be subject to retesting.

The total number of proxy votes received for the 2004 AGM represented approximately 69.5% (2003 – 53.5%) of the issued share capital of the Company. The Company is supportive of initiatives to promote greater shareholder participation and offers CREST members the facility to appoint a proxy or proxies through the CREST electronic proxy appointment service. Further details of this service may be found in the enclosed Notice of the Annual General Meeting.

Compliance Statement

The Company has, throughout the year, consistently applied the Principles of Good Governance and Code of Best Practice, which together comprise the 2003 FRC Code appended to the Listing Rules of the Financial Services Authority except that J R Kerr-Muir remained on the Audit Committee (C.3.1) and Remuneration Committee (B.2.1) until 24 December 2004 and 31 January 2005 respectively. A Whistle Blowing Policy (C.3.4) was not fully implemented until July 2004. The Company now fully complies with all the detailed provisions in Section 1 of the 2003 FRC Code.

Statement of Directors' Responsibilities

UK company law requires the Directors to prepare Accounts for each financial year which give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that period. In preparing those Accounts, the Directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Accounts; and
- Prepare the Accounts on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and Group and enable them to ensure that the Accounts comply with the Companies Act 1985.