

# Corporate governance

In June 1998 the Combined Code on Corporate Governance was issued and was subsequently adopted by the London Stock Exchange. This Code contains 14 principles of good governance applicable to listed companies and the paragraphs below, together with the Remuneration Report on pages 13 to 16 disclose how these principles are applied within the Group.

**Directors** The Group is controlled through the Board of Directors. During 1999 there were at least three Executive Directors and, at all times, four independent Non Executive Directors. All Directors are able to take independent professional advice in furtherance of their duties if necessary. The Board has a formal schedule of matters reserved to it and has met seven times during 1999. It is responsible for overall Group strategy, acquisition and divestment policy, approval of major capital expenditure and reorganisation projects and consideration of significant financing matters. It monitors the exposure to key business risks and reviews the strategic direction of the trading divisions, their annual budgets, their progress towards achievement of those budgets and their capital expenditure programmes. The Board also considers environmental and employee issues as well as key appointments. It ensures that all Directors receive appropriate training on appointment and subsequently as appropriate. All Directors, in accordance with the Code, will submit themselves for re-election at least once every three years.

The Board has established a number of standing committees. The principal committees are the Audit Committee, the Remuneration Committee and the Nomination Committee.

**Relations with shareholders** The Group encourages two-way communication with its institutional and private investors and responds quickly to all queries received verbally or in writing. The preliminary and interim results are presented to analysts and meetings with shareholders are arranged as appropriate. All shareholders have at least twenty one days' notice of the Annual General Meeting at which Directors and Committee Chairmen are introduced and available for questions.

**Financial reporting** Reviews of the performance of each of the Divisions and the overall financial position of the Group are included in the Operational and Financial Reviews on pages 2 to 6. The Board uses this, together with the Chairman's statement and the Directors' report on pages 8 and 9 to present a balanced and understandable assessment of the Group's position and prospects.

**Wider aspects of Internal Control** The Board expects to have the procedures in place by 6 September 2000 to implement the guidance 'Internal Control – Guidance for Directors on the Combined Code'. This takes account of the time needed to put in place the required procedures.

**Internal Financial Control** The Directors are responsible for the Group's system of internal financial control and for renewing its effectiveness. The key control procedures are described under the following five headings.

**Management structure** As a large, geographically dispersed multinational business, the Group operates through a divisional structure. Each Division has a board of directors which accounts on a regular basis through its Chief Executive to the Chairman for its performance. Management review meetings are held quarterly for each Division at which its progress for the previous quarter is reviewed and subsequently reported to the Board at its next meeting.

**Financial reporting** There are comprehensive management reporting disciplines which involve the preparation of annual budgets by all operating units. The budgets are reviewed by Divisional management and are subsequently passed to the Board for approval. Monthly results are reported against the approved budget and revised forecasts are prepared at quarterly intervals.

**Investment appraisals** The Group has a clearly defined framework for capital expenditure including appropriate authorisation levels beyond which such expenditure requires the approval of the Board. There is a prescribed format for capital expenditure applications which places high emphasis on the commercial and strategic logic for the investment and demands a high quality of financial presentation of the business case. As a matter of routine,

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projects are also subject to post-investment appraisal after an appropriate period.

**Functional reporting** The Group has identified a number of key areas which are subject to annual reporting to the Board. These include treasury operations and corporate taxation matters. Other areas given particular emphasis are information management strategy and risk management, the latter including environmental, legal and insurance matters.

**Internal Audit** In January 1999 the Group outsourced its internal audit function to PricewaterhouseCoopers who report to the Finance Director. The scope of internal audit covers a wide variety of operational matters and, as a minimum, ensures compliance with the Group's specified standards. The direct reporting route to the Finance Director ensures appropriate actions are taken and can be reported back to the Audit Committee on a timely basis.

It is the view of the Board that the overall quality of internal financial control across the Group can be related directly to the controls in individual operating units. It is therefore a requirement for the managers of operating units and the Divisions to confirm in writing the quality of internal financial control in their area. The statements are required in respect of each financial year as part of the year-end accounting process and are reported to the Audit Committee.

The Board has reviewed the effectiveness of the system of internal financial control for the accounting year and the period to the date of approval of the financial statements. It has considered the major business risks and the control environment. A system of internal financial control can provide only reasonable and not absolute assurance against material misstatement or loss. As referred to in note 3 to the financial statements, the result for the year has been impacted by losses of £5.6 million (net of estimated recoveries) arising from irregularities in the North American Fashion Retail business over several years involving local senior management. Since discovery of the irregularities by internal audit, the Board immediately took corrective action including dismissing the local senior management involved. The Board believes that appropriate procedures

and controls are now operating effectively and additional monitoring procedures are now in place.

**Audit Committee** The Audit Committee, comprising of the Non Executive Directors, has specific terms of reference which deal with its authorities and duties. It meets at least three times a year with the external auditors and internal auditors attending by invitation. The Committee oversees the monitoring of the adequacy of the Group's internal financial controls, accounting policies and financial reporting and provides a forum through which the Group's external auditors and internal auditors report to the Non Executive Directors. This forum may take place without the presence of an Executive Director.

**Going concern basis** After making enquiries, the Directors have formed a judgment, at the time of approving the financial statements, that there is a reasonable expectation that the Group has reasonable resources to continue in operational existence for the foreseeable future. For this reason, the Directors continue to adopt the going concern basis in preparing the financial statements. This Statement also forms part of the Operational and Financial Reviews.

**Environmental review** The statements below set out the Group's environmental management policy.

**Environmental management** The Group's international businesses must satisfy a range of regulatory regimes and stakeholder expectations so the Group requires local management to take responsibility for environmental performance, within the framework of the Group's environmental policy, defined standards and procedures. This policy, which has recently been reviewed and updated, has been signed off by the Chief Executives of the Coats and Viyella Divisions, and is published on our web site. Further information, including progress against targets and achievements of individual businesses will be added during the year.

Environmental management communication networks and action groups are in place across the Group to assist implementation of the Group's environmental policy, monitor issues and performance, and exchange best

practice. In each business, a senior executive takes overall responsibility for environmental performance, supported by site environmental management representatives for local co-ordination.

#### Environmental auditing and reporting system

- Units monitor their environmental matters and related costs, and prepare an annual self-assessed audit report, evaluated for reliability by our external auditors on a sample basis.
- The audit process covers environmental management systems, emissions, energy and resources management, compliance, customer issues and external interests.
- The award-winning environmental audit software, developed by the Coats Division to facilitate audit data input, analysis, benchmarking and reporting has also been adopted by the Viyella Division.
- Businesses are required to incorporate improvement targets in environmental action plans.
- A summary of the results, for the 122 units completing the 1999 self assessment, is set out on our web site, and we note that some progress has been made in achieving Group defined levels of performance in key areas of environmental management.

- The number of environmental incidents leading to action by regulatory authorities, which were reported to the Group, has reduced further to four. None of these incidents has resulted in prosecution and whilst no significant adverse environmental effects resulted, action is being taken to prevent reoccurrence.

**External verification** This statement and a sample of self assessed audits, have been reviewed by Deloitte & Touche, Environmental Consultants. Their verification is based on an examination of relevant documentation and a series of interviews with site management and other Group executives. Their verification statements will be available on our web site.

**Risk management** Senior management identify the areas of significant potential business and legal risk. The identification, monitoring and, where necessary, reduction of significant risk to the Group are presented to the Board. The Board reviews and approves the parameters under which such risks are managed prior to adopting a business plan.

## Compliance statement

The Listing Rules require the Board to report on compliance with the forty-five Code provisions throughout the accounting period. The Group has complied throughout the accounting period ended 31 December 1999 with the provisions set out in Section 1 of the Code.

The Group has adopted the transitional approach for internal control aspects of the Combined Code as permitted

by the London Stock Exchange in their letter of 27 September 1999 to all listed companies and the Group has therefore complied with Code provision D.2.1 on internal control by reporting on internal financial control in accordance with the guidance on internal control and financial reporting issued in December 1994.