

The Combined Code on Corporate Governance published by the Financial Services Authority contains 14 principles of good governance applicable to listed companies and the paragraphs below together with the Report on Directors' remuneration on pages 13 to 18 disclose how these principles are applied within the Group.

Directors

The Group is controlled by a Board of Directors, the majority of whose members are Non Executive. All Directors are able to take independent professional advice in furtherance of their duties as necessary. The Board has a formal schedule of matters reserved to it and met seven times during 2002. It is responsible for the overall Group strategy, acquisition and divestment policy, approval of major capital expenditure, 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 and key appointments. It ensures that all Directors receive appropriate training on appointment and then 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, Remuneration Committee, Nomination Committee and Risk Management 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 other meetings with shareholders are arranged as appropriate. All shareholders have at least twenty working days notice of the Annual General Meeting at which all Directors and Committee Chairmen are available for questions.

Financial reporting

Reviews of the performance of the Divisions and the overall financial position of the Group are included in the Chief Executive's review and Financial review on pages 2 to 7. The Board uses these, together with the Chairman's statement on page 1 and the Directors' report on pages 9 and 10, to present a balanced and understandable assessment of the Group's position and prospects.

Statement of internal control and risk management

The Directors are responsible for the Group's system of internal control and for regularly reviewing its effectiveness. It is recognised that such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide

reasonable and not absolute assurance against material misstatement or loss.

An ongoing process for identifying, evaluating and managing the significant risks faced by the Group has been established. This process has been operational for the year under review and up to the date of approval of the Annual Report and Accounts. The process is regularly reviewed by the Board and accords with the Internal Control Guidance for Directors on the Combined Code produced by the Turnbull working party.

As part of the establishment of a formal risk management infrastructure to suit the geographically dispersed nature of the Group, key individuals within each of the businesses have been identified to act as risk co-ordinators. At the end of every quarter each Risk Co-ordinator completes a self-assessment questionnaire on aspects of operational, legal and asset risk. These quarterly returns are endorsed by the Managing Director of the business, with an assertion of the effectiveness of the system of internal control. These in turn are reviewed centrally and a summary report is prepared for the Risk Management Committee together with an evaluation of the significant risks which affect the business achieving its strategic objectives. The Finance Director reports quarterly to the Risk Management Committee on financial risks affecting the Group, including the work of internal audit.

The Risk Management Committee comprises the Executive Directors and the Managing Director of Bedwear and, until that division was sold, the Chief Executive of Fashion Retail. The Committee meets quarterly to discuss all risk matters affecting the Group. Other key senior executives are invited to attend the Risk Management Committee, as required. The Risk Management Committee is responsible for the co-ordination of Group wide risk management, including the regular review of the quarterly risk reports and reviews the effectiveness of the system of internal control. The Risk Management Committee reports on a quarterly basis to the Board.

Internal financial control

The Directors are responsible for the Group's system of internal financial control and for reviewing 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 or a management committee which accounts for its performance on a monthly basis through its Divisional Head to the Group Chief Executive. Management review meetings are held regularly for each Division at which the Division's progress is reviewed and subsequently reported to the Group 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 successively reviewed by executive management and passed to the Board for approval. Monthly results are reported against the approved budget and revised forecasts are prepared at regular 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 financial presentation of the business case. As a matter of routine, 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

The internal audit function is carried out by PricewaterhouseCoopers, who report to the Finance Director and have access to the Audit Committee on a regular basis. 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 that 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 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.

Audit Committee

The Audit Committee, comprising of the Non Executive Directors, has specific terms of reference which set out its authorities and duties. It meets formally at least three times a year with the external and internal auditors. 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 and internal auditors report to Non Executive

Directors. This forum may take place in private without the presence of an Executive Director.

Environmental Management

The Group requires local management in its international businesses to take responsibility for environmental performance, within the framework of the Coats Worldwide Environmental Policy. This Policy is published on the Company's website, together with further details of the Group's approach to environmental management and achievements of individual businesses.

Units prepare an annual self-assessed report, covering Environmental Management Systems (EMS), emissions, energy and resources management, compliance, targeted action planning, customer issues and external interests. These are evaluated for reliability by the Group's external auditors on a sample basis. In addition to the self-assessment process, site visits are undertaken by the Group, supporting risk management and enabling the sharing of good practice.

The results, for the 85 units completing the 2002 self assessment are summarised on the Company's website. The year saw continued strengthening in Environmental Management practices amongst the business units, with particular progress in newer sites and continued integration of acquisitions into the Coats EMS. Four environmental incidents leading to intervention by the regulatory authorities were reported to the Group. These did not result in prosecution and action has been taken to prevent re-occurrence.

This statement and a representative sample of self assessed reports, have been reviewed by Deloitte & Touche. Their verification statement is available on the Company's website.

Compliance statement

Throughout the year ended 31 December 2002 the Group has been in compliance with the Code provisions set out in Section 1 of the Combined Code on Corporate Governance published by the Financial Services Authority.