

Corporate governance

Compliance with the Combined Code

The Group continues to be committed to the principles of corporate governance contained in the Combined Code for which the Board is accountable. In the year ended 31 December 2006 a number of changes to the Group Board had an impact on the Board's full compliance with the code.

Board changes in the year:

- Rod Aldridge stepped down as Executive Chairman to Non-Executive Chairman in March 2006 and retired from the Board on 31 July 2006
- Eric Walters was appointed as Non-Executive Chairman with effect from 1 August 2006
- Simon Pilling was promoted to become an Executive Director of the Group Board, having previously been a member of the Divisional Executive Board, with effect from 1 August 2006
- Bill Grimsey was appointed as Non-Executive Director with effect from 9 October 2006.

For each appointment, the Board undertook a formal and rigorous recruitment process, led by the Nomination Committee and, where appropriate, with the assistance of independent external search consultants.

The Group has complied throughout the year with the provisions of Section 1 of the Combined Code except in 2 circumstances; in respect of the independence of the Board and in respect of the number of independent non-executive directors on the Audit and Remuneration Committees between 1 August to 9 October 2006, as follows:

- Independence of the Board (A.3.2) – following the retirement of Rod Aldridge as Non-Executive Chairman on 31 July 2006, Eric Walters was appointed as Non-Executive Chairman to the Board (a Non-Executive Director of The Capita Group Plc since January 2001) with effect from 1 August 2006 and on 9 October 2006, Bill Grimsey was appointed as a Non-Executive Director of the Board. We recognise that with 4 Executive Directors, excluding the Non-Executive Chairman, the Board does not fully comply with the Combined Code regarding the balance of the Board. However, the Board believes that the current composition of the Board is more in line with the principles of the code as it is led by a Non-Executive Chairman and its composition remains suitable for the nature and size of the Group. We believe that the collective skills, experience and approach to running the business is appropriate for driving the Group forward and achieving the Group's goals. We constantly review the composition of the Board to ensure that it continues to meet the needs of the Group.
- The Code recommends 3 independent Non-Executive Directors be appointed to the Audit Committee (C.3.1) and the Remuneration Committee (B.2.1). Eric Walters had served on both committees. Therefore, following his appointment as the Group's Chairman, both committees comprised of 2 Non-Executive Directors for the period from 1 August to 9 October 2006. This position was resolved with the appointment of Bill Grimsey to the Audit and Remuneration Committees on 9 October 2006. However, the Audit and Remuneration Committees did not meet during this period.

The Board's Non-Executive Directors, Peter Cawdron, Eric Walters, Martina King and Bill Grimsey are regarded as independent and free from any business or other relationship that could materially interfere with their judgment.

For the purposes of the Combined Code, Peter Cawdron has served on the Board for 9 years. The Board is satisfied that Peter Cawdron remains independent with strong financial skills and a good knowledge of the business and its sectors and continues to enhance the overall balance of the Board.

Board responsibilities and effectiveness

The Board is collectively responsible to shareholders for setting the direction of the business and monitoring the Group's ongoing affairs. It is also responsible for ensuring an effective internal control environment that identifies and manages appropriately the risks associated with the business [pages 27 and 37](#).

The Board demonstrates its commitment to the strategic direction and control of the Group by scheduling a series of meetings in the year. It can meet as necessary outside of this schedule to consider any urgent matters that may arise. It sets the strategic objectives of the Group, ensuring sufficient financial and human resources are in place to meet those aims. The Board sets the Group's values and standards and ensures that its obligations to clients, employees, suppliers, the community and other key stakeholders are understood and met. The Board has a formal schedule of matters specifically reserved to it for decision including the Group's business strategy, annual budget, annual and interim financial results, dividends and major corporate activities. The Board also considers regular reports from the Chief Executive, Group Finance Director and Joint Chief Operating Officers. The Board is provided with complete, timely and relevant information to ensure that informed judgements are made in pursuit of the Group's objectives.

The Board also reviews the performance of management in meeting business objectives, plans the succession of key executives, and determines appropriate remuneration levels through the Remuneration Committee, a committee of the Board. The operational management of the Group is delegated to the Divisional Executive Board, which meets monthly. Its composition is set out in the Divisional Executive Board section [page 65](#).

The Non-Executive Directors have a particular responsibility to challenge constructively and independently the business development plans that are proposed by executive management and monitor the performance of the management teams in the delivery of agreed business objectives and targets. The Non-Executive Chairman encourages and engages in an open dialogue with Non-Executive Directors in particular, who are at liberty to meet with him as a group or individually as they feel fit, without the presence of Executive Directors. Directors and officer's liability insurance is maintained.

Board composition

The Directors acknowledge the need to segregate the responsibility for operating the Board from the management of the underlying business. Consequently, the roles of Non-Executive Chairman (Eric Walters) and Chief Executive (Paul Pindar) are separated.

The Board consists of the Non-Executive Chairman, Eric Walters; 3 further independent Non-Executive Directors, Peter Cawdron (Senior Independent Director), Martina King and Bill Grimsey, 4 Executive Directors; Paul Pindar, Chief Executive, Gordon Hurst, Group Finance Director and Company Secretary and Paddy Doyle and Simon Pilling, Joint Chief Operating Officers.

The Senior Independent Non-Executive Director is available, as necessary, to lead meetings of the Non-Executive Directors without the Executive Directors and/or the Chairman being present and meet with shareholders to understand any concerns. Biographies of the Directors can be found on [pages 64-65](#).

Director induction and professional development

Simon Pilling received an appropriate induction programme on joining the Group Board. Bill Grimsey received a comprehensive induction programme involving appropriate documentation, meetings and visits to Capita businesses with other Directors, attendance at Divisional Board meetings and discussions with advisers and senior management from across the Group.

All Board members have access to independent advice on any matters relating to their responsibilities as Directors and as members of the various committees of the Board, at the Group's expense. The Company Secretary, Gordon Hurst, who is also Group Finance Director, is available to all Directors and he is responsible for ensuring that all Group Board procedures are complied with.

The decision to combine the roles of Finance Director and Company Secretary was taken when Capita was a smaller entity and as the Group has evolved this approach has been regularly reviewed and has proven to work well. Capita owns a company secretarial business that provides services to numerous private and quoted companies and a team from this business directly supports Gordon Hurst in his role as Company Secretary.

Corporate governance

During the year, the Directors received appropriate ongoing briefings and information, including updates on governance and regulatory issues, to enable them to perform their roles. They also attended external courses where appropriate.

Board performance evaluation

At the January 2007 Board meeting the Board reviewed the report from the board performance evaluation process carried out for 2006, the outcome of which was positive.

The various Committees repeated the self-assessment exercise carried out last year in order to assess whether their terms of reference had been satisfactorily fulfilled and how their processes and methods could be improved.

The performance of individual Executive Directors is appraised annually by the Chief Executive, to whom they report. The performance of the Chairman is reviewed by the Non-Executive Directors, led by Peter Cawdron, taking into account the views of the Executive Directors. The performance review of the Chief Executive is conducted by the Non-Executive Chairman, taking into account the views of other Directors. Non-Executive Directors' performance is reviewed by the Non-Executive Chairman, taking into account the views of other Directors.

Re-appointment

All Directors are subject to election at the first Annual General Meeting after their appointment and to re-election at intervals of no more than 3 years in accordance with the Combined Code.

The Non-Executive Chairman has, following the evaluation process described above, considered the performance of Paul Pindar and Peter Cawdron, who are subject to re-election at the 2007 Annual General Meeting and is satisfied that they continue to be effective and demonstrate a clear commitment to the role.

Nomination Committee

The Nomination Committee comprised Peter Cawdron (Chairman), Eric Walters and Martina King throughout the year and Bill Grimsey from October 2006. The Committee reports to the Board and its duty is to seek suitably skilled and experienced candidates to be Non-Executive Directors and ensures plans are in place for orderly succession for appointments to the Board.

Due to Rod Aldridge's retirement from the Board, the Nomination Committee met during the year under review for the purposes of appointing a Non-Executive Chairman, an Executive and a Non-Executive Director to the Board.

A rigorous review, taking into account the need for progressive refreshing of the Board, was carried out. Core competencies and attributes required to fill the roles were set out. Independent external search consultants were engaged, where appropriate, to identify potential candidates. It should be noted that Eric Walters excused himself from the discussions regarding the consideration of his nomination and appointment as Non-Executive Chairman.

Audit Committee

The Audit Committee comprised the Non-Executive Directors throughout the year and was chaired by Peter Cawdron. He has significant and recent relevant financial experience. Audit Committee meetings are also attended, by invitation, by the Non-Executive Chairman, Chief Executive, Group Finance Director, Group Compliance Director, Head of Risk Management and by representatives of the external auditors.

At their meetings, the Committee reviewed a wide range of financial reporting and related matters including the half-year and annual accounts prior to their submission to the Board. The Committee focused in particular on critical accounting policies and practices adopted by the Group and any significant areas of judgement that materially impact reported results. It also monitored the internal controls that are operated by management to ensure the integrity of information reported to shareholders.

The Committee provides a forum for reporting by the Group's external auditors, and it advised the Board on the appointment, independence and objectivity of the external auditors and on their remuneration both for statutory audit and non-audit work. It also discussed the nature, scope and timing of the statutory audit with the external auditors. The Audit Committee annually performs an independent assessment of the suitability and performance of the external auditors in making its recommendation to the Board for their re-appointment.

The Committee reviewed the appropriateness of the annual internal audit programme for the Group, to ensure that the business risk management and internal audit functions are adequately sponsored and resourced. It also monitors the resourcing levels and performance of the Group's Financial Services Authority compliance function.

At the meeting to review the 2006 Annual Report and Accounts, the Committee considered the level of non-audit services being provided by the Group's external auditors in order to satisfy itself that the objectivity and independence of the external auditors is safeguarded. There is a policy in place to monitor and approve the use of the auditors for non-audit services. Details of audit and non-audit fees are given in note 6 on page 90. The lead partner is rotated on a 5 year basis and, consequently, a new lead partner was appointed for the 2006 audit process.

Remuneration Committee

Details of the Remuneration Committee and its activities are given in the Directors' Remuneration Report on pages 71-75.

The terms of reference of the Nomination, Remuneration and Audit Committees are displayed in the investor centre at www.capita.co.uk

Board and committee members, frequency of meetings and attendance

During 2006 the Board met 9 times, excluding ad hoc meetings solely to deal with procedural matters. The Nomination Committee and the Remuneration Committee met 3 times during the year. The Audit Committee met 4 times during the year. Attendance is recorded in the table below.

Any Directors' non-attendance at Board Meetings or meetings of the Audit, Remuneration or Nomination Committees was due to illness or an absence previously agreed with the Chairman of the Board, the Chief Executive or the Chairman of the relevant committee.

	Scheduled Board meetings	Nomination Committee meetings	Remuneration Committee meetings	Audit Committee meetings
Eric Walters	8 (9)	3 (3)	3 (3)	3 (4)
Paul Pindar	7 (9)	–	–	–
Gordon Hurst	7 (9)	–	–	–
Paddy Doyle	8 (9)	–	–	–
Simon Pilling*	3 (3)	–	–	–
Peter Cawdron	8 (9)	3 (3)	3 (3)	4 (4)
Martina King	9 (9)	3 (3)	3 (3)	4 (4)
Bill Grimsey*	2 (2)	–	–	1 (1)
Rod Aldridge (retired July 2006)	4 (6)	–	–	–

Figures in brackets indicate the number of meetings held in the period in which the director was a member of the Board/Committee.

*Simon Pilling and Bill Grimsey's Board attendance following their appointments in August 2006 and October 2006 respectively. Bill Grimsey was also appointed to the Nomination and Remuneration Committee which have not met since his appointment.

Dialogue with institutional shareholders

The Board encourages and seeks to build up a mutual understanding of objectives between the Group and its institutional shareholders. As part of this process, the Non-Executive Chairman, Chief Executive, Group Finance Director and Joint Chief Operating Officers make regular presentations and meet with institutional shareholders to discuss any issues of concern, to obtain feedback and to consider Corporate Governance issues. All the Non-Executive Directors are available to meet with shareholders to understand their views more fully. The Non-Executive Chairman and the Senior Non-Executive Director are personally available to the significant shareholders in the Group.

Corporate governance

The Corporate Communications team has effective day-to-day responsibility for managing shareholder communications and always acts in close consultation with the Board. A Disclosure Committee consisting of the Corporate Communications Director, Chief Executive and Group Finance Director ensures all appropriate communications are made to the London Stock Exchange and shareholders. Shareholders can also access up-to-date information through the investor centre section of the Group's website. A telephone helpline, 0870 162 3100, provides a contact point directly to the Group's registrars.

All members of the Board, including Non-Executive Directors, receive a report on any significant discussions with shareholders and the feedback that follows the half yearly presentations to investment analysts and shareholders is also circulated. All brokers' reports and analysts' briefings are circulated to Directors.

The Board encourages shareholders to attend its Annual General Meeting. Directors, including the chairmen of the various committees, are present to answer any questions from shareholders. The Group uses the Annual General Meeting to communicate with private investors and encourages their participation.

Social and environmental responsibility

Details of how we manage our social and environmental responsibilities can be found on [P](#) pages 54-57.

Internal control

The Group Board is responsible for the Group's system of internal control and for regularly reviewing its effectiveness. Procedures have been designed for, inter alia, the safeguarding of assets against unauthorised use or disposition, maintaining proper accounting records and the reliability of financial information used within the business or for publication. 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 errors, losses or fraud. There is an ongoing process of identifying, evaluating and managing the significant risks faced by the Group, which has been in place throughout the year under review and up to the date of approval of the Annual Report and Accounts. This process is regularly reviewed by the Group Board. The Group's key internal control procedures include the following:

- the Divisional Executive Board has responsibility to set, communicate and monitor the application of policies, procedures and standards in areas including operations, finance, legal, commercial and regulatory compliance, human resources and health and safety, information security and property management and corporate social responsibility and the environment
- authority to operate the individual businesses comprising the Divisions that make up the Group is delegated to their respective Managing Directors within limits set by the Divisional Executive Board under powers delegated by the Group Board. The appointment of executives to the most senior positions within the Group, other than Group Board appointments, requires the approval of the Divisional Executive Board. It establishes key operational, functional and financial reporting standards for application across the whole Group. These are supplemented by operating standards set by local management teams, as required for the type of business and geographical location of each subsidiary and business unit
- comprehensive annual financial plans are prepared at the individual business unit level and summarised at the Divisional and Group level. Financial plans are reviewed and approved by both the Divisional Executive Board and the Group Board. Capital expenditure is subject to rigorous budgetary control beyond specified levels and detailed written proposals have to be submitted to the Group Board. Expenditure on acquisitions is the subject of appropriate consideration, review and approval by the Group Board
- results are monitored routinely by means of comprehensive management accounts and actual progress against plan is challenged directly by executive members of the Group Board on a Group-wide basis at the business unit level each month

- a framework is in place to identify, assess and mitigate the major business risks, including credit, liquidity, operations, reputation, regulatory and fraud. The framework also includes specific provision for risk-based due diligence in respect of business acquisitions and new customer contracts. Exposure to business risks is monitored as an integral part of the monthly challenge to business results discussed above and by the Group Audit Committee

- the risk framework is supplemented in certain of the Group's businesses, including all financial services related business streams, by a number of formally constituted local boards, which in turn are underpinned by dedicated risk committees. These provide an appropriate means to routinely monitor the risk profile of these businesses, including regulatory risks, and for proposed mitigating actions to be challenged and tracked

- the risk management framework is monitored and developed as required by the Group Risk and Business Assurance function, in conjunction with the Group Compliance function, to ensure that it remains appropriate to business requirements and consistent with best practice

- the Group Risk and Business Assurance function reports to the Group Finance Director and independently to the Group Audit Committee. In addition to independently facilitating the Group's risk management framework, it delivers a risk-based internal audit programme, to provide assurance on the effectiveness of the internal control structures operating across the business. The annual audit programme is focused on areas of greatest risk to the Group, as determined by the Group risk framework, and the independent view of those risks taken by the Group Risk and Business Assurance function

- in addition, regulatory risks and compliance matters are overseen by the Group Compliance function reporting through the Group Finance Director and independently to the Group Audit Committee. The Group Compliance team, in conjunction with dedicated Compliance teams within the relevant businesses, independently monitor regulatory compliance by way of risk-based work programmes and support operations in identifying and mitigating regulatory risks as an integral part of the Group's risk framework

- both the Group Compliance function and the Group Risk and Business Assurance function routinely appraise the Group's senior management and the Group Audit Committee of their work programmes and findings.

The Group Board keeps under review the effectiveness of this system of internal control. The key mechanisms used by the Group Board to achieve this include regular reports from the Divisional Executive Board; periodic updates from the Audit Committee based on its review of risk management, business assurance and compliance reports by the relevant Group functions; discussions with and reports from the external auditors and other advisors and periodic reports from relevant Regulators. In addition, the Divisional Executive Directors and Divisional Finance Directors provide annual confirmation that the Divisions' internal controls and systems are designed:

- to provide accurate financial information
- to adequately safeguard, verify and maintain accountability of the Group's assets
- to ensure that provision is made for all amounts known to be irrecoverable at the balance sheet date
- to ensure that accruals are accurately stated and, to the extent that they are known, all potential liabilities have been notified.

At several of its meetings during the year, the Group Board considered the means by which it monitors the effectiveness of internal controls and concluded that it was satisfied with the process and its compliance with the Internal Control Guidance for Directors on the Combined Code issued by the Institute of Chartered Accountants in England and Wales.