

Corporate governance

Since before its flotation, the Group has recognised and continues to recognise the importance of, and is committed to, high standards of corporate governance. The Stagecoach Board is accountable to shareholders and others for the Group's activities and is responsible for the effectiveness of corporate governance practices within the Group. In accordance with the Listing Rules issued by the Financial Services Authority, this statement describes how the principles of good corporate governance that are set out in the Combined Code have been applied.

The Board

The Stagecoach Board currently comprises the Chairman, Chief Executive, four other executive directors and six non-executive directors: the offices of Chairman and Chief Executive are held separately. The directors' biographies appear on pages 34 and 35 of this Annual Report and illustrate the directors' range of experience, which ensures an effective Board to lead and control the Group.

The non-executive directors bring an independent viewpoint and create an overall balance operating in the interests of both the Group and the shareholders. The senior independent non-executive director is currently Barry Sealey. Barry Sealey has indicated his intention not to seek re-election as a non-executive director at the Annual General Meeting on 31 August 2001. It is the Board's intention that following the retirement of Barry Sealey, Robert Speirs will become the senior independent non-executive director. A further non-executive director will be appointed in due course.

The executive and non-executive directors have a complementary range of financial, operational and entrepreneurial experience that ensures no one director or viewpoint is dominant in the decision-making process. During the financial year ending 30 April 2001, we have appointed Russell Walls and Janet Morgan as non-executive directors, and Graham Eccles as an executive director.

These appointments further broaden the collective experience of the Board.

All directors meet regularly with other senior management and staff of the Group, have access to confidential advice from the company secretary and may take independent legal or other professional advice at the Group's expense where it is considered necessary for the proper discharge of their duties as directors.

All directors submit themselves for election by shareholders at the Annual General Meeting following their appointment and all directors are required to stand for re-election by shareholders every three years. Each director receives training on appointment, and subsequently as is considered necessary, to keep abreast of matters affecting their duties as directors. The number of full Board meetings during the year was nine. The full Board meets once a year at an operational location and regular communications, both written and verbal, are maintained by the Chairman to ensure all directors are briefed on strategic and operational issues. Non-attendance at the Board or committees occurs only in very exceptional circumstances. The Board has a number of matters reserved for its consideration, with principal responsibilities being to agree the overall strategy and investment policy, to approve major capital expenditure and vet acquisitions or disposals, to monitor performance of senior management and to ensure that there are proper internal controls in place. All directors have full and timely access to information with Board papers distributed in advance of meetings.

The Board carries out an annual review of the effectiveness of the Board as a whole and the contribution made by each director. To provide effective and proper control, certain of the Board's powers have been delegated to committees.

The operational management of the Group is delegated by the Board to the Chief Executive and executive directors who meet regularly with non-board senior management. There are four principal operating divisions (Coach USA; UK Bus; UK Rail; Overseas Bus) which each comprise a varying number of autonomous business units each headed by a chairman or managing director who is responsible for the day to day performance of the business unit. The UK Bus division is headed by an executive director of the Group and the UK Bus managing director, who are supported by a small team of senior management and other specialists. The division is divided into twelve principal operating units, each headed by a managing director who reports to the managing director of UK Bus. The UK Bus division has its own management board which includes three Group executive directors (the Group Chief Executive, Group Finance Director and Executive Director – UK Bus), and other senior management. Coach USA is headed by the Coach USA Chairman (who is an executive director of the Group) who reports to the Group's Chief Executive. Coach USA has its own management board that comprises the Coach USA Chairman, the

Group Chief Executive, the Group Finance Director and other senior management. The division comprises eight regions, each headed by a regional vice-president who reports to the Coach USA Chairman. The Overseas Bus division is headed by the Overseas Bus Chairman and each business is headed by a managing director who is responsible for the performance of the business unit. The Group Chief Executive generally attends the Board and management meetings of the principal overseas bus operations. However, to allow the Group Chief Executive to devote more attention to Coach USA, the Group Chairman has attended the overseas bus meetings during the year whilst the Chief Executive has attended periodically. At South West Trains, an executive director is the Chairman and this role is separate from the managing director who is responsible for the performance of the business unit. They are supported on the South West Trains board by the Group Chief Executive and two non-executive directors. Virgin Rail Group is headed by a Chief Executive and Board meetings are attended by two Stagecoach executive directors. Stagecoach is involved in all key decisions at Virgin Rail Group. Road King Board meetings are attended by two Stagecoach executive directors.

The Group holds periodic meetings with its principal shareholders and welcomes all shareholders to its AGM. Formal notice of the 2001 meeting is enclosed within this annual report.

Audit Committee

The Audit Committee comprises four non-executive directors and at the present time, its members are Russell Walls (Chairman), Janet Morgan, Robert Speirs and Ewan Brown. Barry Sealey served on the Audit Committee during the year and was replaced by Janet Morgan subsequent to year-end. The Audit Committee met four times during the year. It receives reports from management and from the Group's internal and external auditors relating to the scope and results of the audit, the interim and annual accounts, the risk management process and the accounting and internal control systems in place throughout the Group. The Audit Committee reviews the cost effectiveness, independence and objectivity of the external auditors. The Audit Committee approves the audit fees and reviews significant non-audit related services provided by the auditors and affiliated firms. The Committee has unrestricted access to the auditors, and vice-versa.

The Chairman of the Audit Committee reports to the Board on the work undertaken by the committee.

Remuneration Committee

The Remuneration Committee during the year comprised four non-executive directors (Barry Sealey, Robert Speirs, Russell Walls and Ewan Brown) and was chaired by Robert Speirs. The Remuneration Committee met four times during the year. It is responsible for reviewing the scale and structure of the remuneration of the executive directors and the terms of their service contracts and is also responsible for approving grants of and changes to the company's performance-related incentive schemes and executive share option schemes.

Nominations Committee

The Nominations Committee currently comprises three non-executive directors (Janet Morgan, Robert Speirs and Ewan Brown) and is chaired by the Group's Chairman, Brian Souter. The purpose of the Committee is to propose to the Board any new executive and non-executive director appointments. The Committee was convened three times during the year.

Directors' remuneration

The Remuneration Committee makes recommendations to the Board for ensuring that the directors' remuneration is appropriate to attract, retain and motivate executive directors of the quality needed to run the Group successfully. The Committee believes that remuneration packages should contain significant performance related elements. Performance targets are established to achieve consistency with the interests of shareholders, using an appropriate balance of long and short term targets. The constitution and operation of the Remuneration Committee complies with the principles and provisions of the Combined Code and this is detailed in the remuneration report laid out on pages 51 and 52.

Relations with shareholders

The Board considers communications with shareholders, whether large or small, external or employees, to be extremely important. The Group holds periodic meetings with major institutional shareholders, other fund managers and representatives of the financial press. The programme of investor relations includes presentations in London of the full year and interim results and meetings with institutional investors in the UK and overseas. Investor and analyst feedback is sought after presentations to ensure principal issues are being effectively communicated and shareholder objectives are known. During the year written responses are given to letters or e-mail received from

shareholders and all shareholders receive Interim and Annual Reports or the summary financial statements. In order to provide a more focused communication with shareholders and to meet their varying requirements, each shareholder receives either a full annual report or a summary annual report. Each shareholder is given the opportunity to elect which document they require and this allows our reporting to be more focused towards the needs of individual shareholders. Information is also available on the company website (www.stagecoachgroup.com). Private and institutional shareholders are welcome to attend and participate at the AGM. The Group aims to ensure that the chairmen of the Audit, Remuneration and Nominations Committees are available at the AGM to answer questions. The AGM provides an opportunity for shareholders to question the Chairman and other directors on a variety of topics and further information is provided at the AGM on all the Group's principal business activities. The Chairman formally announced details of all proxy votes lodged for each resolution after each show of hands at the 1999 and 2000 AGMs and this practice will continue.

Accountability and audit

The Board endeavours, in all its communications with shareholders, to present a balanced and understandable assessment of the company's position and prospects.

The Board considers acceptance of appropriate risks to be an integral part of business. Where the Board considers a risk to be of an unacceptable level such risks are either avoided or insured through third parties. Internal controls are used to identify and manage acceptable levels of risk. The directors acknowledge their responsibility for establishing and maintaining the Group's system of internal control. Although the system can provide only reasonable and not absolute assurance of material misstatement or loss, the Group's system is designed to provide the directors with reasonable assurance that any risks or problems are identified on a timely basis and dealt with appropriately. The Group has established an ongoing process of review and certification by the business heads of each operating unit.

Certain of the Group's businesses are subject to significant risk. We have, for example, experienced during the year, the disruption to the UK rail network arising from the actions outwith the Group's control. Each identified business risk is assessed for its probability of occurrence and its severity of occurrence. Where necessary, the

Board considers whether it is appropriate to accept certain risks (such as railway disruption) that cannot be fully controlled or mitigated by the Group. The Group's risk management process was embedded throughout its businesses during the year ended 30 April 2001. The Board has carried out a review of the effectiveness of the Group's internal control environment and such reviews are conducted on an ongoing basis. The Board is satisfied that the process is in place to ensure that risks are mitigated to an acceptable level.

The Board has designated specific individuals to oversee the internal control and risk management processes, while recognising that it retains the ultimate responsibility for these processes. The Board believes that it is important that these processes are embedded throughout the business and the managing director of each operating unit is responsible for the internal control framework within that unit. As part of the risk management process it is intended that the non-executive directors will periodically meet with the managing directors of each operating unit because this is one method by which an independent appraisal of risk management is obtained.

Ongoing self assessment of risk conducted by the directors and senior management is taking place. Risk has been considered at several levels and each division has a separate risk profile. Risks are evaluated within broad risk categories: external, reputation, strategic and competitive, legal and regulatory, business change, people, financial performance and operational performance.

The internal audit function is utilised in monitoring risk management processes to determine whether internal controls (operational, compliance and financial) are effectively designed and properly implemented. A risk-based approach is applied to the implementation and monitoring of controls. The monitoring process also forms the basis for continually improving the risk management process in the context of the Group's overall goals.

Internal audit plans and reports are reviewed by the Audit Committee together with external audit plans and any business improvement opportunities that are recommended by the external auditors.

Virgin Rail Group has its own audit committee and internal audit function. The Group's risk management process does not

specifically cover Virgin Rail Group at present, but the Group maintains an overview of risk management at Virgin Rail Group. Members of the Board and the internal audit function meet with representatives of Virgin Rail Group to ensure that the joint venture follows appropriate risk management procedures. Road King Infrastructure has its own audit committee and internal audit function. The Group's Audit Committee review the financial statements of Virgin Rail Group and Road King Infrastructure together with the minutes, external audit presentations, management presentations and internal audit presentations from the respective audit committee meetings of these companies.

Internal control

The wider process described above, together with the key procedures noted below, enables the directors to confirm that they have reviewed the effectiveness of the system of internal control of the Group during the year. The key procedures, which the directors have established, are as follows:

- an annual budgeting process with regular reforecasting of outturn, identifying key risks and opportunities. All budgets are presented to a panel of the executive directors by each business unit's management team, before being approved by the Board prior to the commencement of the financial year.
- four-weekly reporting of financial information to the Board encompassing profit and loss, cash flow, balance sheet and key performance indicators and operating ratios. All results are monitored throughout the year by the Group executives.
- an internal audit function which reviews key business processes and financial controls, reporting directly to the Audit Committee.
- third party reviews commissioned by the Group of areas where significant inherent risks have been identified, such as treasury management and competition policy.
- a decentralised organisation structure with clearly defined limits of responsibility and authority to promote effective and efficient operations.
- control over the activities of joint ventures and associated undertakings through Stagecoach representation on the Boards of the entities together with regular contact between Stagecoach management and the management of the relevant entities.
- a performance management appraisal system is in place which covers over 100 of the Group's senior management and is based on agreed financial and other performance objectives many of which incorporate identifying and managing risk.
- significant emphasis is placed on cash flow management. Bank balances are reviewed on a daily basis, cash flows are compared to budget on a four-weekly basis and any material variances between earnings and expected cash flows are investigated.
- regular Board reporting on specific matters including insurance, treasury management, foreign exchange, interest and commodity exposures. The Board regulates treasury management policies and procedures.
- defined capital expenditure and other investment approval procedures, including due diligence requirements where material businesses are being acquired or divested.
- each operating unit maintains controls and procedures appropriate to the business. It is a key requirement of the procedures that a written certificate is provided annually by the managing director and financial manager of each business confirming that they have reviewed the effectiveness of the system of internal financial control during the year. As might be expected, a number of minor internal financial control weaknesses were identified by this procedure, all of which have been, or are being, addressed. None of the weaknesses have resulted in any material losses, contingencies or uncertainties that would require disclosure in the Group's Annual Report. This process is considered to be an integral part of the continuous improvement of our risk management procedures.
- a commitment to best practice in external reporting.
- a competition compliance programme which has been approved by the Board and which is subject to regular monitoring.

The Audit Committee, having considered the external auditors' performance during the year, recommended re-appointment. The audit fees of £0.7 million and non-audit related fees of £0.2 million were discussed and considered appropriate given the current size of the Group and the level of corporate activity undertaken during the year. The Committee believes the level of non-audit services does not impair the objectivity of the auditors and that there is a clear benefit obtained from using professional advisors who have a clear understanding of the Group's operations. Other accounting firms have been used where the Group recognises them as having particular areas of expertise or where potential conflicts of interest for the auditors are identified.

Compliance with the Combined Code

The Group has complied with the provisions of the Code throughout the financial year except that one director has a service contract that is terminable by the Group with two years' notice. The Board believes it is in the best interests of shareholders to retain key executive directors. The length of directors' service contracts will be reviewed on an annual basis having regard to prevailing market conditions and practice amongst UK public companies.

Pension schemes

The assets of the Group's pension schemes are totally separate from the assets of the Group and are invested with independent fund managers. There are twelve trustees for the principal UK scheme of whom five are employee representatives nominated by the members on a regional basis and one is a pensioner trustee. Three of the executive directors are trustees together with two senior management colleagues. Derek Scott, the Company Secretary, who is an elected member of the NAPF's investment council, acts as chairman of the board of trustees and in 1998 was also re-elected to the 16-member board of the industry-wide Railways Pension Scheme. The auditors and actuaries of the principal UK pension scheme are both independent of the Group. Similar arrangements are in place for the SWT and Island Line sections of the Railways Pension Scheme. The London and Newcastle offices of Arthur Andersen audit the Railways Pension Scheme, but Arthur Andersen does not audit any other significant pension schemes in which the Group participates.