

Corporate governance

The Group 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.

In July 2003, a Revised Combined Code was issued for financial years commencing on or after 1 November 2003. The Group currently complies with most of the recommendations contained in the Revised Code and will keep under review its current corporate governance practices in light of the recommendations contained within it for its financial year ending 30 April 2005. The Directors have, however, made the following initial observations in regards to potential non-compliance with the provisions contained in the Revised Code:

- The Audit Committee should include at least three members, who should all be independent non-executive directors. The Stagecoach Audit Committee comprises four non-executive directors, all of whom are considered by the Board to be independent.
- Half of the Board, excluding the Chairman, should be independent non-executive directors. The Board believes that the Group satisfies this recommendation because it considers Ewan Brown to be an independent non-executive director.
- The Nomination Committee should comprise a majority of independent non-executive directors. The Board believes that the Group satisfies this recommendation.

One of the non-executive Directors, Ann Gloag, is not an independent director. The Board has determined nevertheless that it complies with the above provisions as it considers Ewan Brown to be independent, notwithstanding the existence of circumstances which may appear relevant to that determination, due to the reasons stated below.

The Board

The Stagecoach Board currently comprises the Chairman (who is a non-executive director), the Group Chief Executive, two other executive directors and five other non-executive directors. Five of the six non-executive directors are considered by the Board to be independent. In the case of Ewan Brown, the Board in its determination has taken into account the less than 1% shareholding in the company held by Noble Grossart Investments Limited, Mr. Brown's outstanding service on the Board since he was first elected in 1988, and his willingness to stand for annual re-election by shareholders from 2004. The Board has also noted that Mr. Brown has retired as an executive director of Noble Grossart. Mr. Brown is not dependent on the company for his primary source of income and does not participate in any of the Company's bonus, option or pension schemes.

The offices of Chairman and Group Chief Executive have been separately held since 1998.

The Chairman ensures that meetings of the Board and shareholders are properly conducted and is responsible for setting and moving forward the Board's agenda. Leadership of the Board (by the Chairman) is not the same as the leadership required (from the Group Chief Executive) to turn the Board's strategic and policy decisions into actions and to infuse the whole enterprise. The Group Chief Executive has day-to-day responsibility for all business of the Group and carries out the agreed strategy and policies of the Board.

The directors' biographies appear on page 17 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. Russell Walls is the senior independent non-executive director.

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.

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 induction training on appointment and subsequently such training or briefings as are considered necessary to keep abreast of matters affecting their roles as directors. The number of full Board meetings during the year was seven. The full Board meets once a year at an operational location and regular verbal communication is maintained by the Chairman between meetings to ensure all directors are well informed on strategic and operational issues.

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, to monitor performance and risk management procedures of senior management, to ensure that there are proper internal controls in place and to consider major acquisitions or disposals. All directors have full and timely access to information with Board papers distributed in advance of meetings.

The Board keeps the roles and contribution made by each director under review and changes in responsibilities (for example in the composition of Board committees during the year) are made where necessary to improve the Board's effectiveness. To provide a more manageable process and better 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 Group Chief Executive and executive directors. The executive directors maintain day-to-day contact and meet regularly face-to-face or in videoconferences with non-board senior management. There are four principal operating divisions (UK Bus, North America, Overseas Bus and Rail) 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 a managing director, who reports to the Group Chief Executive and is supported by a small team of senior management and other specialists. The division is divided into a number of principal operating units, each headed by a regional managing director who reports to the managing director of UK Bus. The managing director of UK Bus and the other UK Bus directors meet regularly.

Following a series of disposals during the year ended 30 April 2004, North America now comprises three regions (North East, North Central and Canada). Each region is headed by a chief operating officer who reports to the Group Chief Executive.

The Overseas Bus division is headed by a chairman, who reports to the Group Chief Executive and until June 2003, comprised two principal business units, each of which was headed by a managing director responsible for the performance of the business unit. Following the disposal of Citybus in June 2003, the Overseas Bus division consists only of the New Zealand operations.

A Rail board, comprising one Group executive director and other senior management, oversees the performance and development of the Group's rail business. At South West Trains, the aforementioned Group 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 a member of Group management and three non-executive directors. Virgin Rail Group is headed by a chief executive and board meetings are attended by one Stagecoach executive director and one other Stagecoach representative. Stagecoach is involved in all key decisions at Virgin Rail Group.

Until its disposal in January 2004, Road King board meetings were also attended by at least one Group executive director, and the chairman of Overseas Bus.

The Group holds periodic meetings with its principal shareholders and welcomes all shareholders to its AGM and EGMs. Formal notice of the 2004 AGM is enclosed within this annual report.

Evaluation of effectiveness of the Board

The directors have reviewed the effectiveness of the Board as a whole and its Committees. Each director has assessed the effectiveness of the Board and each Committee of which he or she is a member. In the case of the Remuneration Committee, independent consultants have contributed to the assessment of the Committee's effectiveness.

The assessment of effectiveness included:

- Consideration of the effectiveness of the formal Board and Committee meetings.
- The nature and extent of the Board's interaction with the management of the Group.
- The timeliness, relevance and accuracy of the information provided to the Board and its Committees.
- The allocation of the Board's time between differing priorities including the time spent on strategic considerations relative to other matters.
- The composition of the Board and its Committees.

The Board has considered the results of these assessments and has concluded that overall the Board and the Committees continue to operate in an effective and constructive manner.

Audit Committee

The Audit Committee comprises four non-executive directors, all of whom are considered by the Board to be independent. At the present time, its members are Russell Walls (Chairman), Janet Morgan, Ewan Brown and Iain Duffin. Of the members of the Audit Committee, the Chairman is a former Finance Director of a FTSE 100 company and a second member is currently the chairman of an audit committee of another FTSE 100 company. The Committee therefore has significant financial expertise and is appropriately qualified to undertake its duties in an effective manner.

The Audit Committee met four times during the year and has met a further time in June 2004. It receives reports from all of the Group's major business functions including the risk assurance function (internal audit), which is now outsourced and managed by Deloitte. It also receives reports from the external auditors. It considers the scope and results of the audit, the interim and annual accounts and the accounting and internal control systems in place throughout the Group. The Audit Committee reviews the cost effectiveness, independence and objectivity of the internal and external auditors. Subject to the annual appointment of auditors by the

shareholders, the Audit Committee conducts a continuous review of the relationship between the Group and the auditors. This review includes:

- the consideration of audit fees that should be paid and advance approval of any other fees in excess of £50,000 cumulative which are payable to auditors or affiliated firms in respect of non-audit activities;
- the consideration of the auditors' independence and objectivity;
- the nature and scope of the external audit and the arrangements which have been made to ensure co-ordination where more than one audit firm or offices of the same firm are involved; and
- discussions on such issues as compliance with accounting standards.

Procedures in respect of other services provided by the auditors are:

- Audit related services – These are services that the auditors must undertake or are best placed to undertake by virtue of their role as auditors. Such services include formalities relating to bank financing, regulatory reports, and certain shareholder circulars. The auditors would generally provide all such services, subject to approval by the Audit Committee.
- Tax consulting – It is the Group's policy to select the advisor for each specific piece of tax consulting work who has the most appropriate skills and experience for the work required. The Group uses a range of advisors for tax consulting, including the auditors where they are best suited to the work being undertaken, subject to approval by the Audit Committee.
- General consulting – For other consulting work, the Group will select an advisor after taking account of the skills and experience required and the expected cost of the work. The Group uses a range of advisors for general consulting, including the auditors where they are best suited to the work being undertaken. The auditors are only permitted to provide general consulting when the Group, the Audit Committee and the auditors are satisfied that there are no circumstances that would lead to a threat to the audit team's independence or a conflict of interest.

Auditors

The Audit Committee, having considered the external auditors' performance during their period in office, recommends re-appointment. The audit fees of £0.7 million for PricewaterhouseCoopers LLP and non-audit related fees of £0.2m were discussed by the Audit Committee 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 good understanding of the Group's operations. Other accounting or consulting 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.

Remuneration Committee

The Remuneration Committee during the year comprised three independent non-executive directors, Iain Duffin (Chairman), Russell Walls and Janet Morgan. The Remuneration Committee met five 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. It is also responsible for approving grants of and changes to the company's performance-related incentive schemes and executive share option schemes. Exercise of options, which is always subject to the rules of the schemes, is approved by a Committee of the main Board.

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Nomination Committee

The Nomination Committee currently comprises two independent non-executive directors, Robert Speirs and Ewan Brown (who acts as chairman) and one executive director, Brian Souter. The Committee may also include, by invitation on an ad hoc basis, the other non-executive directors, as necessary. The purpose of the Committee is to propose to the Board any new director appointments. Final appointments are the responsibility of the whole Board. The Committee did not meet during the year as there were no new or proposed appointments to the Board. However, they did meet in June 2004 to consider the re-election of directors by rotation.

Health, Safety and Environmental Committee

The Health, Safety and Environmental Committee is chaired by a non-executive director Janet Morgan, and also comprises one other non-executive director, Iain Duffin who joined the Committee in May 2004 and one executive director, Graham Eccles. It was established to discuss health, safety and environmental issues across the Group and to report regularly to the Board on these matters. It has access to internal safety executives and also external consultants. The Committee met twice during the year and again in June 2004.

Individual director attendance at meetings

The following is a table of attendance at meetings by director:

ATTENDANCE AT MEETINGS	Board meetings	Audit Committee	Remuneration Committee	Health, Safety and Environmental Committee
No. of meetings	7	4	5	2
Robert Speirs	6	n/a	n/a	n/a
Brian Souter	7	n/a	n/a	n/a
Martin Griffiths	7	n/a	n/a	n/a
Graham Eccles	7	n/a	n/a	2
Ewan Brown	7	4	n/a	n/a
Iain Duffin	7	4	5	n/a
Ann Gloag	7	n/a	n/a	n/a
Janet Morgan	7	2	4	2
Russell Walls	6	3	4	n/a

Directors' remuneration

The Remuneration Committee makes recommendations to the Board for ensuring that the directors' remuneration is appropriate to attract, motivate and retain executive directors of the quality needed to run the Group's business successfully. The Committee believes that remuneration packages should contain significant performance-related elements. Performance targets are established to align incentives with the interests of shareholders, using an appropriate balance of long- and short-term targets. These include not only traditional financial indicators but also personal targets, successful investment, innovation, staff development, customer satisfaction, achievement of regulatory requirements, including health and safety and environmental 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 24 to 27.

Relations with shareholders

The Board considers communications with shareholders, whether large or small, external or employee, to be extremely important. The Group holds periodic meetings with representatives of 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 key strategies, market trends and actions being taken 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 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 and any EGMs. The Group aims to ensure that the chairmen of the Audit, Remuneration, Nomination and Health, Safety and Environmental 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. At each AGM, the Chairman reports, after each show of hands, details of all proxy votes lodged for each resolution.

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 and unacceptable levels of risk are avoided or reduced and, in some cases, transferred to 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 risk review and certification by the business heads of each operating unit.

Certain of the Group's businesses are subject to significant risk. Each identified business risk is assessed for its probability of occurrence and its potential severity of occurrence. Where necessary, the Board considers whether it is appropriate to accept certain risks that cannot be fully controlled or mitigated by the Group.

The Group's risk management process was embedded throughout the businesses during the year ended 30 April 2004. The Board has carried out a review of the effectiveness of the Group's internal control environment and such reviews are supported on an ongoing basis by the work of the Audit Committee. The Board is satisfied that the processes are 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 ultimate responsibility for these. The Board believes that it is important that these processes remain rooted throughout the business and the

managing director of each operating unit is responsible for the internal control framework within that unit. The Audit Committee meets with representatives of operating units because this is one way for an independent and objective appraisal of risk management to be obtained.

Self-assessment of risk conducted by the directors and senior management is ongoing and has been considered at several levels with each division maintaining a separate risk profile. Risks are evaluated within broad categories: external, reputation, strategic and competitive, legal and regulatory, business change, people, financial performance and operational performance, and social, ethical and environmental risks.

The Group Risk Assurance function, which is now outsourced and managed by Deloitte, 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 maintaining the integrity and improving where possible the Group's full risk management process in the context of the Group's overall goals.

Group Risk Assurance 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 the business risk management through representation on the board and audit committee. Stagecoach management representatives also meet regularly with representatives of Virgin Rail Group to ensure that the joint venture follows appropriate risk management procedures.

The Group's Audit Committee reviews the financial statements of Virgin Rail Group together with the minutes, external audit presentations, management presentations and internal audit presentations from the audit committee meetings.

Internal control

The wider process described above, together with the key procedures noted below, enables the directors and senior group managers 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 re-forecasting of out-turn, identifying key risks and opportunities. All budgets are presented to a panel consisting of executive directors and senior group managers by each business unit's management team, before being approved by the Board prior to the commencement of the financial year.
- 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.
- a Risk Assurance function which reviews key business processes and business 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, insurance provisioning, pensions strategy 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 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 updated key risks, taxation, pensions, 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 control during the year. As might be expected, a number of minor internal 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 maintenance and 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.

Compliance with the Combined Code

The Group has complied with the provisions of the applicable edition of the Combined Code throughout the financial year.

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 ten trustees for the principal UK scheme of whom five are employee representatives nominated by the members on a regional basis. The other trustees include senior Group and UK Bus executives. The company secretary, who is an elected member of the NAPF's investment council, and who in 1998 was also re-elected for a six-year term to the 16-member board of the industry-wide Railways Pension Scheme, acts as chairman of the trustees of the principal UK scheme. The auditors and actuaries of the principal UK pension schemes are both independent of the Group. Similar arrangements are in place for the South West Trains, Island Line, Sheffield Supertram and two Virgin Rail Group sections of the Railways Pension Scheme. PricewaterhouseCoopers LLP does not conduct the external audit of any significant pension schemes in which the Group participates.