

Corporate governance

Introduction

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 July 2003, a revised Combined Code ("the Combined Code") was issued for financial years commencing on or after 1 November 2003.

This section of the report discusses Stagecoach Group's corporate governance arrangements and management structures. It also includes the disclosures recommended by the Combined Code, and describes how the principles of good corporate governance that are set out in the Combined Code have been applied. In line with best practice, separate reports are provided from each of the Audit Committee, Nomination Committee and Remuneration Committee.

Compliance with the Combined Code

The Directors believe that the Group currently complies with all of the recommendations contained in the Combined Code, other than that one of the Non-Executive Directors regarded as independent by the Board does not satisfy all of the criteria suggested by the Combined Code for determining Directors' independence.

Composition of the Board

The Combined Code suggests that independent Non-Executive Directors should make up at least half of the Board (excluding the Chairman). The Company's Board comprises nine Directors. Excluding the Chairman, the Board considers there to be four independent Non-Executive Directors.

		Chairman	Independent Non-Executive Director	Other Director
Robert Speirs	Chairman	✓		
Ewan Brown	Non-Executive Director		✓	
Iain Duffin	Non-Executive Director		✓	
Janet Morgan	Non-Executive Director		✓	
Russell Walls	Senior Independent Non-Executive Director		✓	
Ann Gloag	Non-Executive Director			✓
Brian Souter	Chief Executive			✓
Graham Eccles	Executive Director – Rail			✓
Martin Griffiths	Finance Director			✓

Ewan Brown, one of the four independent Non-Executive Directors, has served on the Board since 1988 and is a non-executive director of Noble Grossart, which is an advisor to the Company. The Company recognises and understands investor concerns over longer-serving Non-Executive Directors but nevertheless continues to regard Ewan Brown as independent. Ewan Brown's long association with the Group enables him to provide a robust and effective challenge to management because of the sound and detailed knowledge of the Group's business that he has developed. The Board believes that Ewan Brown's length of service enhances his effectiveness as a non-executive director and that he remains independent in character and judgement. In recognition of the factors suggested by the Combined Code for determining independence, Ewan Brown will stand for annual re-election as a director. In addition, Ewan Brown does not serve on the Remuneration Committee and while he does serve on the Audit Committee, the other three Independent Non-Executive Directors also serve on that Committee. In assessing independence, the Board takes into account the wider composition and balance of the Board as a whole.

Operation of the Board

The Board is scheduled to meet six times each year. Additional meetings of the Board are held to consider matters arising between scheduled Board meetings, where a decision of the Board is required prior to the next scheduled meeting.

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 split of the Chairman's and Chief Executive's responsibilities is in writing and has been approved by the Board.

The Directors' biographies appear on page 15 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.

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. The Chairman and the Non-Executive Directors periodically meet without the Executive Directors being present: these meetings generally follow each meeting of the full Board. In addition, the Non-Executive Directors, led by the Senior Independent Non-Executive Director, meet without the Chairman at least annually.

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. The Company Secretary, whose appointment and removal is a matter for the Board as a whole, is responsible to the Board for ensuring the Board procedures are complied with.

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 at least every three years. Non-Executive Directors who are not considered by the Board to be independent, or are considered independent but have served on the Board for more than nine years submit themselves for annual re-election. 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 Chairman endeavours to ensure that all Directors (including any newly appointed Directors) attend the Annual General Meeting, providing an opportunity for shareholders to meet the Directors.

The number of full Board meetings during the year was six. 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. The schedule of matters reserved for the Board was reviewed and updated in April 2005. The 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 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.

Minutes are taken of each meeting of the Board and its Committees. Where any director has significant concerns that cannot be resolved about the running of the Group or a proposed action, these concerns are recorded in the minutes. It is also the Group's policy that where a director resigns, the director is asked to provide a written statement to the Chairman of any concerns leading to his or her resignation.

Operational Management of the Group

The Board delegates the operational management of the Group 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, New Zealand 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.

A managing director, who reports to the Group Chief Executive, heads the UK Bus division. A small team of senior management and other specialists support the UK Bus managing director. 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.

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 New Zealand business is headed by a chairman, who reports to the Group Chief Executive. A managing director is responsible for the overall performance of the business unit.

A Rail Business Development Committee, comprising the three Group Executive Directors and other senior management, oversees the performance and development of the Group's rail business, including bidding on new rail franchises.

The Group's principal train operating interests are its wholly owned subsidiary, South West Trains, and its joint venture, Virgin Rail Group. The Group Executive Director for Rail chairs the South West Trains Board, and this role is separate from the managing director who is responsible for the performance of the business unit. However, the former managing director of South West Trains left the Group in March 2005 and the Group Executive Director for Rail is presently undertaking this function until a new managing director is appointed. The South West Trains Board also includes the Group's Company Secretary and three Non-Executive Directors. A Chairman and Chief Executive head Virgin Rail Group. Virgin Rail Group board meetings are attended by the Stagecoach Group Executive Director for Rail and the Company Secretary. Stagecoach is involved in all key decisions at Virgin Rail Group.

Directors and Officers' liabilities

The Group maintains Directors and Officers' insurance. In addition, the Group proposes to provide indemnities to its Directors and Officers in light of recent changes to UK law in this regard. A resolution will be presented to the 2005 Annual General Meeting proposing to adopt new Articles of Association which will, amongst other matters, permit the granting of indemnities to the fullest extent permitted by law.

Performance evaluation

The Board assesses its own performance and the performance of each individual Board member; this assessment is co-ordinated and directed by the Chairman with the support of the Company Secretary. The Senior Independent Non-Executive Director co-ordinates the Board's assessment of the performance of the Chairman. As part of the assessment process, the Non-Executive Directors meet without the Executive Directors being present. The Non-Executive Directors also meet without the Chairman being present. The Chairman obtains feedback from each individual director on the performance of the Board and other Board members – this involves the completion of a questionnaire and a follow-up discussion. In the same way, the Senior Independent Non-Executive director obtains feedback from each individual director on the performance of the Chairman. A similar process is undertaken to assess the performance of each of the Board's Committees.

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 who are considered by the Board to be independent. It receives reports from all of the Group's major business functions including the Risk Assurance Function. 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.

The Audit Committee Report is set out on pages 21 and 22.

Remuneration Committee

The Remuneration Committee makes recommendations to the Board for ensuring that the Executive Directors' remuneration is appropriate to attract, motivate and retain Executive Directors of the quality needed to run the Group's business successfully. 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 23 to 29.

Nomination Committee

The Nomination Committee currently comprises two Non-Executive Directors (one of whom is the Chairman of the Company) that the Board considers to be independent, and one Executive Director. The Committee is responsible for evaluating the balance of skills, knowledge and experience of the Board, and where appropriate suggesting new appointments.

The Nomination Committee Report is set out on page 22.

Health, Safety and Environmental Committee

The Health, Safety and Environmental Committee is chaired by an independent Non-Executive Director, Janet Morgan, and during the financial year comprised one other independent Non-Executive Director, Iain Duffin who joined the Committee in May 2004 and one Executive Director, Graham Eccles. Ann Gloag joined the Committee from June 2005. 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 2005.

The terms of reference of the Health, Safety and Environmental Committee are available on the Group's website at <http://www.stagecoachplc.com/sgc/investorinfo/corpgov>

Individual director participation at meetings

The following is a table of participation in full Board meetings and meetings of committees by director during the year ended 30 April 2005:

PARTICIPATION IN MEETINGS	Full Board meetings	Audit Committee	Remuneration Committee	Health, Safety and Environmental Committee	Nomination Committee
No. of meetings	6	3	4	2	1
Robert Speirs	6	n/a	n/a	n/a	1
Brian Souter	6	n/a	n/a	n/a	1
Martin Griffiths	6	n/a	n/a	n/a	n/a
Graham Eccles	6	n/a	n/a	2	n/a
Ewan Brown	6	3	n/a	n/a	1
Iain Duffin	6	3	4	2	n/a
Ann Gloag	6	n/a	n/a	n/a	n/a
Janet Morgan	6	3	4	2	n/a
Russell Walls	6	3	4	n/a	n/a

Relations with shareholders

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

Corporate governance

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-mails 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 Group's website (www.stagecoachgroup.com).

The Group holds periodic meetings with its principal shareholders. The Board receives regular updates on the views of shareholders through briefings from the Chairman and the Executive Directors, reports from the Company's brokers and reports from the Company's Financial PR consultants. The Senior Independent Non-Executive Director is available to shareholders where contact through the normal channels is inappropriate, or has failed to resolve concerns.

Private and institutional shareholders are welcome to attend and participate at the Annual General Meeting and any Extraordinary General Meetings. The Group aims to ensure that all Directors, including the chairmen of the Audit, Remuneration, Nomination and Health, Safety and Environmental Committees are available at the Annual General Meeting to answer questions. The Annual General Meeting provides an opportunity for shareholders to question the Chairman and other Directors on a variety of topics and further information is provided at the Annual General Meeting on all the Group's principal business activities. Notice of the Annual General Meeting and related papers are distributed to shareholders at least 20 working days before the meeting. It is the Company's policy to propose a separate resolution at the Annual General Meeting for each substantially separate issue. Resolutions are proposed annually in respect of the Report and Accounts, and the Remuneration Report. At each Annual General Meeting, the Chairman reports, after each show of hands, details of all proxy votes lodged for and against each resolution, and the number of abstentions. Details of the proxy votes are also published on the Group's website at <http://www.stagecoachplc.com/sgc/investorinfo/agminfo/>. The Company and its Registrars have established procedures to ensure that votes cast are properly received and recorded.

Risk management

The Group has an ongoing process for identifying, evaluating and managing the significant risks that it faces. The Board regularly reviews the process, and the Board considers that the process accords with the Turnbull Guidance on internal control.

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, and reviewing its effectiveness. 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 financial year ended 30 April 2005 and up to the date of the approval of this report. 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.

The Group Risk Assurance function, which is outsourced to and managed by Deloitte, reports to the Audit Committee and is utilised in monitoring risk management processes to determine whether internal controls 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.

The Audit Committee reviews Group Risk Assurance plans, as well as 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, 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 and the key procedures noted below, enable 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 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. Group management monitor the results throughout each financial year.
- a Risk Assurance function which reviews key business processes and business controls, reporting directly to the Audit Committee.
- third party reviews commissioned periodically 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 the Group's senior management and is based on agreed financial and other performance objectives, many of which incorporate 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. A written certificate is provided at least annually by the management 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 the Board has approved and which is subject to regular monitoring.

Pension schemes

The assets of the Group's pension schemes are held under trust, 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 chairman of the trustees of the principal UK scheme is an elected member of the National Association of Pension Funds' investment council. 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.

During the financial year ended 30 April 2005, a Pensions Oversight Committee was established. This Committee is chaired by a Non-Executive Director and also comprises one Executive Director and other members of senior management. The Committee operates at a strategic level and its remit covers all matters affecting the Group's pension schemes from the perspective of the Company, and it will consider, develop and propose recommendations to the Board in respect of such issues as may arise. The Committee reviews pension scheme funding issues and implications, investment strategy, and the related administration for all of the employee pension schemes of the Company and its wholly owned subsidiaries.

Audit Committee Report

In line with best practice, the Audit Committee has decided to present a separate annual report. This report relates to the financial year ended 30 April 2005.

Composition of the Audit Committee

The Audit Committee comprises four Non-Executive Directors, all of who 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, Russell Walls is a former Finance Director of a FTSE 100 company and Ewan Brown is currently the chairman of an audit committee of a FTSE 100 company. The Committee has significant recent and relevant financial expertise and is appropriately qualified to undertake its duties in an effective manner.

Operation of the Audit Committee

The Audit Committee met three times during the year and has met a further time in June 2005. It receives reports from all of the Group's major business functions including the Risk Assurance Function (internal audit), which is 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.

The terms of reference of the Audit Committee are available on the Group's website at <http://www.stagecoachplc.com/sgc/investorinfo/corpgov>

Review of External Auditors

The Audit Committee has the delegated responsibility for making recommendations on the appointment, reappointment, removal and remuneration of the external auditors. There have been no instances of disagreements between the Board and the Audit Committee relating to the 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.

The Committee formally assesses the effectiveness of the external audit process on an annual basis.

The Audit Committee, having considered the external auditors' performance during their period in office, recommends re-appointment. The audit fees of £0.6m for PricewaterhouseCoopers LLP and non-audit related fees of £0.4m 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 and scope 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.

Policy on the Auditors Providing Non-Audit Services

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.

Review of Risk Assurance Function

The Audit Committee has the delegated responsibility for making recommendations on the appointment, reappointment, removal and remuneration of the Group Risk Assurance Function (internal auditors). There have been no instances of disagreements between the Board and the Audit Committee relating to the Risk Assurance Function.

The Audit Committee conducts a continuous review of the relationship between the Group and the Risk Assurance Function. This review includes a consideration of independence and objectivity, the overall level of fees, the quality of the risk assurance process, and the role of the function in the context of the broader sources of risk assurance.