

6. Corporate governance report

6.1 Introduction

The Stagecoach Board is accountable to shareholders for the Group's activities and is responsible for the effectiveness of corporate governance practices within the Group in conformity with the Combined Code on Corporate Governance ("the Combined Code").

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, Health, Safety and Environmental Committee and Remuneration Committee.

6.2 Compliance with the Combined Code

In July 2006, the Financial Reporting Council published an amended version of the Combined Code. Although the amended version only applies to accounting periods starting on or after 1 November 2006, the Directors believe that from 1 July 2007 the Group will comply with all of the recommendations contained in the amended Combined Code.

However, for a period during the year the Company did not fully comply with the recommendations of the Combined Code. Russell Walls stepped down as a Non-Executive Director on 25 August 2006 and Gary Watts will be appointed as a Non-Executive Director on 1 July 2007. In the period from 25 August 2006 to the date of this report:

- The Audit Committee did not have a Chairman and comprised only two Directors, neither of whom have recent and relevant financial experience. However, Iain Duffin acted as Chairman at meetings and at least one of the Company's other independent Non-Executive Directors who have recent and relevant financial experience was also in attendance at all meetings of the Committee. This ensured that at least two independent Non-Executive Directors attended each meeting.
- The Remuneration Committee comprised only two Directors. However, at least one of the Company's other independent Non-Executive Directors attended meetings of the Committee thus ensuring at least three independent Non-Executive Directors attended each meeting.
- If the criteria for determining independence suggested by the Combined Code were applied, less than half of each of the Board and Nomination Committee (in each case excluding the Chairman) was independent. However, the Board's own view was that at least half of the Board and Nomination Committee (excluding the Chairman) was independent, because it regards Ewan Brown as independent.

Notwithstanding the above, the Board believes that it and its Committees remained effective during this period. The appointment of Gary Watts with effect from 1 July 2007 will remedy the above areas of non-compliance with the Combined Code.

6.3 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). Following Garry Watts' appointment with effect from 1 July 2007, the Company's Board will comprise nine Directors. Excluding the Chairman, the Board considers there will be five independent Non-Executive Directors.

		Independent Chairman	Independent Non-Executive Director	Other Director
Robert Speirs	Chairman	✓		
Ewan Brown	Non-Executive Director		✓	
Iain Duffin	Non-Executive Director		✓	
Sir George Mathewson	Non-Executive Director		✓	
Janet Morgan	Non-Executive Director		✓	
Garry Watts	Non-Executive Director		✓	
Ann Gloag	Non-Executive Director			✓
Brian Souter	Chief Executive			✓
Martin Griffiths	Finance Director			✓

Ewan Brown, one of the five 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 stands for annual re-election as a director. In addition, Ewan Brown does not serve on the Remuneration Committee or the Audit Committee. In assessing independence, the Board takes into account the wider composition and balance of the Board as a whole.

In determining the independence of Non-Executive Directors, the Board considers a number of factors. In particular the Board satisfies itself on the following questions:

- Does the Director provide a robust and effective challenge to executive management?
- Is the Director prepared to challenge others' beliefs, assumptions and viewpoints for the overall good of the Group and its shareholders?
- Does the Director effectively contribute to constructive debate by the Board and its Committees?
- Is the Director willing to defend his or her own beliefs and viewpoints for the overall good of the Group and its shareholders?
- Does the Director have a sound and detailed knowledge of the Group's business that enables him or her to effectively question strategy and executive management's running of the business?

6.4 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. 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 pages 20 and 21 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. 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, including the Chairman, 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 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.

6.5 Operational management of the Group

The Board delegates the operational management of the Group to the Group Chief Executive and Group Finance Director ("Executive Directors"). The Executive Directors maintain day-to-day contact and meet regularly face-to-face or in videoconferences with non-board senior management. Following the Group's disposal of its New Zealand operations in November 2005, there are three principal operating divisions (UK Bus: headed by a Managing Director, North America: headed by two Chief Operating Officers and UK Rail: headed by a Chief Executive) 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. Each chairman or managing director is supported by his/her own management teams.

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

A Chief Executive heads the Group's joint venture, Virgin Rail Group. The Chief Executive of the Rail division and the Company Secretary attended Virgin Rail Group board meetings during the year.

6.6 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.

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; and
- 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 its committees continue to operate in an effective and constructive manner.

6.7 Audit Committee

The Audit Committee currently comprises two independent Non-Executive Directors, but a further director will join the Committee with effect from 1 July 2007. It receives reports from 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 financial statements 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 page 30.

6.8 Remuneration Committee

The Remuneration Committee makes recommendations to the Board for ensuring that the Executive Directors' and senior management remuneration is appropriate to attract, motivate and retain Executive Directors and senior managers of the quality needed to run the Group's business successfully. The constitution and operation of the Remuneration Committee is detailed in the Directors' remuneration report on pages 32 to 38.

6.9 Nomination Committee

The Nomination Committee currently comprises three Non-Executive Directors (one of whom is the Chairman of the Company) that the Board considers to be independent. 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 31.

6.10 Health, Safety and Environmental Committee

The Health, Safety and Environmental Committee is chaired by an independent Non-Executive Director, Janet Morgan, and comprises one other independent Non-Executive Director, Iain Duffin, and one other Non-Executive Director, Ann Gloag. The Committee was established to consider 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 Health, Safety and Environmental Committee report is set out on page 31.

6.11 Individual director participation at meetings

The following is a table of participation in full Board meetings, meetings of committees and the Annual General Meeting by Director during the year ended 30 April 2007:

PARTICIPATION IN MEETINGS	Full Board meetings		Audit Committee		Remuneration Committee		Health, Safety and Environmental Committee		Nomination Committee		Annual General Meeting	
	Actual	Possible	Actual	Possible	Actual	Possible	Actual	Possible	Actual	Possible	Actual	Possible
Robert Speirs	6	6	n/a	n/a	n/a	n/a	n/a	n/a	1	1	1	1
Brian Souter	6	6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	1	1
Martin Griffiths	6	6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	1	1
Ewan Brown	6	6	n/a	n/a	n/a	n/a	n/a	n/a	1	1	1	1
Iain Duffin	6	6	3	3	3	3	3	3	n/a	n/a	1	1
Ann Gloag	6	6	n/a	n/a	n/a	n/a	3	3	n/a	n/a	1	1
Sir George Mathewson – appointed 8 June 2006	6	6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	1	1
Janet Morgan	5	6	2	3	3	3	3	3	1	1	1	1
Russell Walls – resigned 25 August 2006	2	2	1	1	2	2	n/a	n/a	1	1	1	1

6.12 Relations with shareholders

The Board endeavours to present a balanced and understandable assessment of the Group's position and prospects in communications 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-mails received from shareholders and all shareholders can receive annual reports or summary annual reports.

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 the Group's principal business activities. 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 financial statements and the Directors' 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 votes withheld. Details of the proxy votes are also published on the Group's website at <http://www.stagecoachgroup.com/scg/ir/shareholder/agm/>. The Company and its registrars have established procedures to ensure that votes cast are properly received and recorded.

6.13 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 principal risks and uncertainties facing the Group are discussed on pages 15 and 16.

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 for 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 2007 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 processes are in place to ensure that risks are appropriately managed.

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 (or internal audit) 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 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 Virgin Rail Group's business risk management process 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.

6.14 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 periodic re-forecasting of out-turn, identifying key risks and opportunities. All budgets are presented to a panel consisting of Executive Directors and/or senior managers by each business unit's management team, before being approved by the Board.
- reporting of financial information to the Board encompassing income statement, cash flow, balance sheet and key performance indicators. Group management monitors 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 organisational 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 and cash flows are compared to budget on a four-weekly basis.
- regular reporting to the Board and/or its Committees 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 internal 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 and will be monitored and 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 competition compliance programme, which the Board has approved and which is subject to regular monitoring.

6.15 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 a number of independent fund managers. There are ten trustees for the principal UK scheme of whom four are employee representatives nominated by the members on a regional basis and one is a pensioner trustee. The chairman of the trustees of the principal UK scheme is a professional trustee who served for eight years as a fund member elected representative on the National Association of Pension Funds' investment council. He also sits independently on two industry-wide schemes, as a Department of Trade and Industry appointed trustee of the Mineworkers' Pension Scheme and as an elected representative of all railway employers on the board of the Railways Pension Scheme. He was elected Chairman of the Railways Pension Scheme trustees with effect from 1 June 2007. The other trustees of the principal UK scheme include senior Group and UK Bus executives.

PricewaterhouseCoopers LLP ("PwC") acts as the actuary for The Yorkshire Traction Company Limited Pension Plan which was acquired as part of the acquisition of Traction Group Limited during the year ended 30 April 2006. PwC do not act as actuaries or advisors of any of the other principal UK pension schemes.

A Pensions Oversight Committee was in operation throughout the year. 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 Group's shareholders and other stakeholders, 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, investment strategy, risk management, internal controls surrounding pension matters and the related administration for all of the employee pension schemes of the Group and its subsidiaries.