

corporate governance

COMPLIANCE

Corporate governance has been and remains the responsibility of the whole Board. This statement describes how the Company applies the principles and complies with the provisions of The Combined Code and Code of Best Practice published in July 2003, which applied to the Company in respect of the financial year ended December 2004. The Board considers that it was throughout the year ended December 2004 in compliance with the provisions set out in section 1 of The Combined Code other than the ratio of executive and non-executive directors as explained below.

The Board assesses on an ongoing basis its practices to ensure continued compliance with the Combined Code and has allocated responsibility for compliance to appropriate directors or officers. Contact has been made with major shareholders to allow discussion of the Company's governance policy and strategy with the Chairman and the Senior Independent Director.

BOARD COMPOSITION AND PROCEDURES

The Board currently comprises the non-executive Chairman, three independent non-executive directors including a Senior Independent Director and seven executive directors, details of whom are set out on pages 18 and 19. The positions of Chairman, Chief Executive and Senior Independent Director are held by separate individuals and there is a clear division of responsibility between the Chairman and the Chief Executive. This ratio of executive and non-executive directors has applied for a number of years and the Board believes that this membership is the appropriate structure for the Company. The Board is responsible for the Group's business operations and the full executive team of seven directors is present on the Board in order to provide first hand information and contributions to the running of the business. The executive directors control the Group's devolved management structure which requires local management initiative across the Group's global spread of operating companies and the broad product range and wide customer base. Board membership of the seven executives is key to the overall management of the Group which employs a flat management structure. This also provides the non-executive directors with regular direct access to the full executive management team. This is a successful mix and appointing a further four non-executive directors would make the Board very cumbersome and would not add to the quality of the Board's performance. This structure has been maintained in relation to the recently announced Board retirements and appointments which are explained in the Chairman's Statement.

The Board applies an appropriate policy in the recruitment of independent non-executive directors to meet the particular requirements of the Board. The non-executive directors have all had senior executive experience and offer independent judgement on Board matters. The non-executive directors of the Company, including the Chairman, do not participate in any bonus, share option or share ownership schemes and their appointments are non-pensionable.

The Board meets formally six times per year to consider strategic developments and to review trading results and operational and business issues. In particular it deals with those matters reserved to it for decision. The matters reserved to the Board are posted on the Group web site: www.SpiraxSarcoEngineering.com and are as follows:-

(i) Management

- Approval of Group strategy and annual plans.
- Commitments relating to the acquisition or disposal of any company or business by the Group.
- Material or unusual contracts.
- Capital expenditure items in excess of £500,000 or such other limit agreed by the Board. Items over £250,000 but less than £500,000 are reported to each quarterly meeting of the Board.

(ii) Board Membership and Board Committees

- The formal appointment and dismissal of directors.
- Terms of reference and membership of Board committees.

(iii) Corporate Governance/Accounting

- Approval of actions requiring public documents including circulars to shareholders, related documents and press releases.
- Approval of accounting policies or practices, including the Treasury policy.
- Individual borrowings, financial instruments, guarantees or provision of equity capital, beyond the authority of the Finance Committee.
- Approval of the content of the Annual Report and Accounts and the Interim Statement.
- Appointment and dismissal of Company Secretary.
- Through the Audit Committee, remuneration of auditors and recommendation for appointment and removal of auditors.
- Dividend policy, interim dividends and proposed final dividends.
- Any matter to be dealt with at an AGM or EGM.

(iv) Other

- Significant alterations to existing Group Risk Management policies relating to insurance, environmental and health and safety matters.
- Changes in principal professional advisers.
- Major changes to pensions and employee share schemes operated in the Group.
- Prosecution, defence or settlement of any material litigation.

All directors receive detailed progress reports one week prior to each Board meeting.

The non-executive directors met together both with and without the Chairman during the year. Utilising a format created with the advice of Towers Perrin, the Board again carried out a rigorous board performance evaluation process in accordance with the Combined Code requirements which confirmed the effective operation of the Board. The Board will be repeating this exercise annually.

There are procedures for individual Board members to receive induction and training as appropriate and provision to solicit independent professional advice at the Company's expense where specific expertise is required in the course of exercising their duties. All directors have access to the Company Secretary, who is responsible for ensuring compliance with appropriate statutes and regulations.

The Company continues to provide directors' and officers' insurance for Board members and the directors of Group subsidiary companies.

All directors are subject to re-appointment by shareholders at the first opportunity after their appointment and thereafter at intervals of no more than three years.

SENIOR INDEPENDENT DIRECTOR

During the year Mr. M. Townsend was the Senior Independent Director.

COMMITTEES

The Board delegates specific responsibility to Board committees, notably the Audit, Nomination and Remuneration Committees in line with best practice. The terms of reference for these committees are posted on the Group web site: www.SpiraxSarcoEngineering.com. Additionally the executive directors comprise the Risk Management Committee.

(i) Audit Committee

The Audit Committee comprised Messrs. E. Lindh, M. Townsend (Chairman) and W. H. Whiteley. All members are independent in accordance with the independence criteria set out in the Combined Code. There were three meetings of the Audit Committee during the year and all members attended all meetings, with the exception of Mr. E. Lindh who was unavailable for one meeting.

A summary of the Audit Committee's duties and responsibilities is set out on page 25.

(ii) Nomination Committee

The Nomination Committee comprised Messrs. T. B. Fortune (Chairman), E. Lindh, M. J. D. Steel, M. Townsend and W. H. Whiteley. There were three meetings of the Nomination Committee and all members attended all meetings.

The Nomination Committee proposes to the Board new appointments for both executive and non-executive directors and determines on an individual basis the most appropriate method of identifying suitable applicants. The Nomination Committee arranges for the executive Board members' views to be assessed before an appointment decision is made.

(iii) Remuneration Committee

The Remuneration Committee comprised Messrs. E. Lindh, M. Townsend (Chairman) and W. H. Whiteley. There were four meetings of the Remuneration Committee and all members attended all meetings, with the exception of Mr. E. Lindh who was unavailable for one meeting.

The Directors' Remuneration Report presented by the Board of Directors is set out on pages 30 to 37.

corporate governance *(continued)*

COMMITTEE MEMBERSHIPS AND SENIOR INDEPENDENT DIRECTOR

Following the annual general meeting on 12th May 2005, at the conclusion of which Mr. T. B. Fortune will retire as Chairman and from the Board, Committee appointments as set out below will apply:-

Mr. M. Townsend will succeed Mr. T. B. Fortune as Chairman of the Nomination Committee and Mr. W. H. Whiteley becomes the Senior Independent Director and will succeed Mr. M. Townsend as Chairman of the Audit and Remuneration Committees.

Mr. G. Bullock will be a member of the Audit, Nomination and Remuneration Committees having been appointed with effect from 2nd May 2005.

Mr. E. Lindh remains a member of the Audit, Nomination and Remuneration Committees.

The Company Secretary continues to act as Secretary to the Audit, Nomination and Remuneration Committees.

SHAREHOLDER RELATIONS

The Group conducts regular dialogue with institutional shareholders and provides such information as is permitted within the guidelines of the Listing Rules. In particular major shareholders have been approached with a view to discussing the Company's governance and strategy with the Chairman and Mr. M. Townsend, the Senior Independent Director. As required by major shareholders, the Senior Independent Director is available to listen to their views on any areas of concern they may have. To date, the non-executive directors have not been requested to attend any meetings with them. Reports are made to the Board of all meetings with major shareholders and analysts, including, in particular, briefings after interim and final results.

The preliminary results announcement may be accessed by individual investors on the Group web site, www.SpiraxSarcoEngineering.com. The Report and Accounts will also be on the web site in due course.

All shareholders are invited to participate in the annual general meeting, where the chairmen of the Audit, Nomination and Remuneration Committees will be available to answer questions. The results of proxy votes are declared at annual general meetings after each resolution has been dealt with on a show of hands and this practice will continue at future general meetings.

INTERNAL CONTROLS

The Board has overall responsibility for the system of internal control and for reviewing its effectiveness, whilst the role of management is to implement Board policies on risk and control. The Board reviews the effectiveness of internal controls at least annually. The reviews cover all material controls, including financial, operational and compliance controls and risk management systems. The system of internal control is designed to manage rather than eliminate the risk of failure to achieve the business objectives.

In pursuing these objectives, internal controls can provide only reasonable and not absolute assurance against material misstatement or loss.

As required by the UK Listing Authority, the Company has complied throughout the year and up to the date of this report, with the Combined Code provisions on internal controls having established the procedures necessary to implement the guidance issued by the Turnbull Committee and by reporting in accordance with that guidance.

(i) Risk Management

The Group has operated procedures for considering risks in the normal operations of the Group and with regard to significant transactions. Strategic and annual planning also encompasses considerations of business risks. The Risk Management Committee specifically reviews any risks facing the business which could give rise to a significant loss.

In November 2003, the Risk Management Committee reviewed the risk register and risk management process first established in 1999 in the context of the current business structure and operations with the aim of validating the risk register and the general risk management process and identifying any additional new risks. This exercise conducted with Marsh Ltd revised the risk register and reviewed risk magnitude and risk likelihood against the current controls and areas for improvement. The Board, on Marsh's advice, is satisfied that the system of management for significant risks is appropriate for the Company and is properly executed.

As part of the on-going process, the Group companies have reported on a six monthly basis their position with regard to implementing the identified countermeasures to address the Group's significant business risks. The six monthly returns are assessed by the Risk Management Committee. Reports are made to the Board as a whole, by the Chief Executive, for review of the risks and measures taken. Annually the executive directors carry out a reappraisal of the business risks. The Audit Committee reviews the system of reporting and monitoring and its effectiveness as a whole.

(ii) Financial

The Finance Committee of the Board considers financing and investment decisions concerning the Group, including the giving of guarantees and indemnities, and monitors policy and control mechanisms for managing treasury risk within the limits laid down by the Board.

Financial reporting systems include comprehensive annual plans approved by the Board and monthly reporting of actual results with appropriate comparisons against plan and previous year's results. Forecast operating results for the year are regularly updated. Capital investment is subject to approval under a clear policy. This includes annual plans, appropriate authorisation, detailed investment appraisal and post-investment review and due diligence requirements where businesses are being acquired.

(iii) Operational

All subsidiaries of the Group are required to complete self-certification questionnaires regarding compliance with the policies, procedures and minimum requirements for an effective system of internal control. Self certification is given by both the general manager and the finance manager of the operation.

(iv) Audit Committee

The Audit Committee has met to consider the appropriateness and effectiveness of the Group's internal controls, policies and procedures and the outcome of the external audit for the year. Its meetings are normally attended by the Director - Finance and the external auditors. There is provision for the Committee to confer with the auditors without the attendance of executive directors. The Audit Committee reviews the independence of the external auditors on an annual basis. The Committee considers in detail reports prepared by the auditors in relation to the interim and final accounts and accounting practices and developments. It also considers reports and explanations provided by the Director - Finance.

The Board has approved terms of reference for the Audit Committee meeting the requirements of the Combined Code. The Audit Committee's responsibilities include:

- monitoring the integrity of the financial statements and in particular reviewing the Company's internal controls and risk management framework;
- reviewing the scope and results of the auditors' work, their independence and objectivity and audit fee, including the requirement for an internal audit function;
- reviewing the accounting policies and practices of the Company and at the end of the annual audit cycle, to assess the effectiveness of the audit process.

(v) Non-Audit Services

A policy on non-audit services provided by the auditors in line with professional practice has been established and approved by the Audit Committee. The external auditor has undertaken non-audit work (essentially in regard to taxation and acquisition due diligence) and the fees paid by the Company for it are set out in Note 7 to the accounts on page 47. The scope and extent of non-audit work undertaken by the Company's auditors is carefully controlled in line with the written terms provided by the Company to the auditors with the objective of avoiding impact on their independence and objectivity. Particularly the auditors are prohibited from providing services in relation to valuations, recruitment, dispute resolution and accounting assistance. The Audit Committee monitors the scope of the auditors' work.

(vi) Whistle Blowing

If any employee in the Group has reasonable grounds for believing that the Business Code/Management Code is being breached by any person or group of people and does not feel able to voice the matter with his or her manager, he or she is able to contact directly the Company Secretary in Cheltenham and provide full details. The Company Secretary will ensure that (a) the circumstances are properly investigated and (b) the employment of the person contacting the Company Secretary will be protected appropriately.

INTERNAL AUDIT

The Board assessed the requirement for an internal audit function and concluded that the current arrangements, which do not require such a function, remain satisfactory.

GOING CONCERN

After making enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

DIRECTORS' RESPONSIBILITIES

The Statement of Directors' Responsibilities is set out on page 38.