

# 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 on Corporate Governance published in July 2003, which applied to the Company in respect of the financial year ended 31st December 2007. The Board considers that, subject to the explanation of the ratio of executive and non-executive directors below, the Company met the requirements of the Combined Code throughout the year ended 31st December 2007. The Board has also applied the principles and provisions in the revised Combined Code published by the Financial Reporting Council in June 2006. The Board assesses on an on-going 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**

During the year the Board comprised 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 24 and 25. During the year the positions of Chairman, Chief Executive, Chief Operating Officer and Senior Independent Director were held by separate individuals. There is a clear written 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 was the established 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 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 additional non-executive directors would make the Board very cumbersome and would not add to the quality of the Board's performance. Following the appointment of Mr. M. E. Vernon as Chief Operating Officer he relinquished direct responsibility for the Americas. The Board structure has been refined whilst maintaining the essential benefit of a successful mix of non-executive and executive directors. The divisional structure will be retained with additional senior managers acting as regional group managers to provide support in the International and European divisions.

The Board applies an appropriate policy in the recruitment of independent non-executive directors to meet the particular requirements of the Board. Each of the non-executive directors has a letter of appointment which meets the requirements of the Combined Code. 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 normally six times per year to consider strategic developments and to review trading results and operational and business issues. All directors attended all meetings in 2007. In particular the Board 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](http://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 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 annual general meeting or extraordinary general meeting.

**(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. There is provision for the non-executive directors to meet together both with and without the Chairman.

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 and reflected the importance of strategic matters. The evaluation process comprises a review conducted by the Company Secretary and reported to the Chairman of all directors' views on the operation of the Board and the performance of the Chairman, the Chairman and Chief Executive's review of the Board performance of each director, the Chairman's review of the non-executive directors and the review by Committee members and attendees of the operations of the Audit, Nomination and Remuneration Committees and the performance of the Chairman of each of those Committees. The evaluation confirmed a continued high rating for the Board's operations and encompassed Board constitution, Board meetings, Board functionality, communication and knowledge management, Company secretariat performance, assessment of the Chairman's performance and the effectiveness of the Board's Committees.

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. W. H. Whiteley 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](http://www.SpiraxSarcoEngineering.com). Additionally the executive directors comprised the Risk Management Committee and Messrs. M. Townsend, M. J. D. Steel and D. J. Meredith comprised the Finance Committee. Mr. M. E. Vernon will replace Mr. M. J. D. Steel with effect from 1st April 2008.

**(i) Audit Committee**

The Audit Committee comprised Messrs. G. Bullock, E. Lindh and W. H. Whiteley (Chairman). 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.

A summary of the Audit Committee's duties and responsibilities is set out on page 31.

**(ii) Nomination Committee**

The Nomination Committee comprised Messrs. M. Townsend (Chairman), G. Bullock, E. Lindh, M. J. D. Steel and W. H. Whiteley. There were three meetings of the Nomination Committee and all members attended all meetings. Mr. M. E. Vernon will replace Mr. M. J. D. Steel with effect from 1st April 2008.

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. The Nomination Committee fully followed this process in the appointment of Mr. M. E. Vernon as Chief Operating Officer and subsequently his appointment as Chief Executive with effect from 1st April 2008. The Committee took professional advice from Kaisen Consulting Limited in arriving at its recommendation. Kaisen Consulting Limited supported the view that the strength of the internal applicants meant it was not necessary to seek external applicants.

**(iii) Remuneration Committee**

The Remuneration Committee comprised Messrs. G. Bullock, E. Lindh and W. H. Whiteley (Chairman). All members are independent in accordance with the independence criteria set out in the Combined Code. There were three meetings of the Remuneration Committee and all members attended all meetings.

The Directors' Remuneration Report presented by the Board of Directors is set out on pages 36 to 43.

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

# Corporate governance continued

## **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. W. H. Whiteley, 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. There were no requests received from shareholders for meetings with the Chairman or the non-executive directors during 2007. 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 investors on the Group web site: [www.SpiraxSarcoEngineering.com](http://www.SpiraxSarcoEngineering.com). The Report and Accounts is also on the web site.

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. Details of the proxy votes received will be published on the Group web site: [www.SpiraxSarcoEngineering.com](http://www.SpiraxSarcoEngineering.com), following the annual general meeting.

## **INTERNAL CONTROLS**

The Board has overall responsibility for the system of internal controls and for reviewing its effectiveness, whilst the role of management is to implement Board policies on risk and control. There is an ongoing process for identifying and managing risks faced by the Company which has been in place for the year under review and up to the date of approval of the annual report and accounts. The reviews cover all material controls, including financial, operational and compliance controls and risk management systems. The system of internal controls is designed to manage rather than eliminate the risk of failure to achieve the business objectives.

The Board believes from its reviews that the system of internal controls is embedded in the business and regular review allows for assessment of new and changing risks in the Group's business.

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 consideration of business risks. The Risk Management Committee specifically reviews any risks facing the business which could give rise to a significant loss.

The Risk Management Committee commenced a review prior to the year end with external consultants, Marsh Ltd, of the risk register and risk management process 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 which could involve a significant risk to the Group's business. This exercise was completed early in 2008 and reviewed the risk magnitude and risk likelihood and significant potential new risks were assessed and counter-measures established. The Board, on Marsh Ltd'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.

In the UK the operation of the Incident Management Team, established in 2006, to deal with the situation immediately after any major incident has been reviewed and the Team strengthened during the year. This model is to be adopted by Spirax Sarco Inc. and by the manufacturing operation in France. Applying incident management techniques the significant impact of flooding in Cheltenham and the lack of water supplies were overcome by considerable efforts by the management and employees of Spirax-Sarco Ltd. During the period and subsequently output was maintained in the Cheltenham factories and shipments were achieved in line with planned levels.

### **(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 controls. 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. The Committee also reviewed the outcome of internal audit reports during the year. Its meetings are normally attended by the Director - Finance, the external auditors and, at the invitation of the Committee, the Chairman. 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 accounts and in particular reviewing the Company's internal controls, risk management framework and internal audit reports;
- reviewing the scope and results of the auditors' work, their independence and objectivity and audit fee;
- recommending the appointment, re-appointment or removal of external auditors;
- reviewing the accounting policies and practices of the Company and at the end of the annual audit cycle, assessing the effectiveness of the audit process.

The Audit Committee reviewed and noted compliance with the good practice list of matters established by the Audit Committee Institute in all material matters.

### **(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 auditors have 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 6 on page 55. 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 services. The Audit Committee monitors the scope of the auditors' work, and approval for fees over established thresholds is specifically required from the Committee Chairman or the full Audit Committee.

### **(vi) Whistle Blowing**

If any employee in the Group has reasonable grounds for believing that the Business Code or 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**

During 2006 the Board reviewed the need for an enhanced internal audit function. As a result an internal audit function was established which allows each of the Group's subsidiaries to be audited at least every four years. The internal audit resource was supplemented by experienced qualified accounting staff from principal Group subsidiaries and a professional auditing firm, BDO Stoy Hayward LLP, is also used for most audits. Reports are made to the Audit Committee and the Board as a whole. The implementation of the internal audit function was successfully achieved and no significant matters were raised in the reports made in the 10 subsidiaries audited during the year.

### **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 44.