Corporate governance

This statement outlines how the Company continues to apply the principles of corporate governance to its activities.

The board and its committees

The board conducts itself in such a way as to give an appropriate lead to the whole group. The board's lead focuses on integrity and personal responsibility with the aim of creating shareholder value.

The board currently comprises six directors, two of whom are executive and four of whom are independent and non-executive. In choosing directors the Company looks for individuals who provide a wealth of business experience, strong personal skills and independence of thought and perspective.

The board met six times during the year, with ten meetings scheduled for 2003, and operates under agreed terms of reference which delegate certain powers to board committees. The terms of reference for both the board and the committees are updated as and when new situations, requirements or practices emerge. The members and Chairman of the committees are shown on page 15. The committees are composed of non-executive directors only, although the executive directors are invited to attend parts of the Funding & Audit Committee meetings.

The Nominations Committee meets as and when required to consider proposals for the appointment of new directors. The suitability of candidates is assessed and a formal proposal then put to the board. Before a nomination is formally made, each director would have an opportunity to meet the candidate. One third of the directors submit themselves for re-election each year.

The Remuneration Committee is responsible for ensuring the remuneration packages of the executive directors are appropriate to attract, motivate and retain high calibre individuals. Executive directors' remuneration packages are set having reviewed competitors' levels and industry norms, collected by independent parties. The Remuneration Report on pages 22 to 25 contains more detailed information on the remuneration of directors.

The Funding & Audit Committee's terms of reference include the duties set out in the Combined Code. The committee monitors the adequacy and effectiveness of the internal financial controls and reviews the interim and annual financial statements before submission to the board to ensure they present a balanced and understandable assessment of the group's position and prospects. The committee also makes recommendations to the board regarding the auditors and their terms of appointment. This committee meets at least three times a year and reports to the board.

The Company's auditors attend all meetings of the Funding & Audit Committee and have direct access to the members at any time. The non-executive directors may take independent professional advice on any matter relating to the Company at the Company's expense. In advance of both board and committee meetings all directors receive detailed papers on the matters to be considered, enabling them to request further clarification or additional information.

Relations with shareholders

The Company has a policy of maintaining an active dialogue with institutional shareholders through individual meetings. Communications with private shareholders are conducted through the annual report, presentations at the annual general meeting and the Company's internet site that inter alia gives a full description of the group's business operations.

Compliance with the Combined Code

Throughout the year ended 31 December 2002 the Company has been in compliance with the provisions set out in Section 1 of the Combined Code on Corporate Governance appended to the Financial Services Authority Listing Rules except for:

- A.2.1 The posts of Chairman and Chief Executive are held by Mr Gawler. This position was ratified by shareholders at the annual general meeting held in 2001. In addition there is a strong and independent non-executive element on the board with a recognised senior member other than the Chairman and Chief Executive to whom concerns can be conveyed.
- B.1.7 The period of notice from the employer for executive directors during the year was 24 months. Under their contractual terms this notice period was scheduled to reduce to 12 months with effect from 6 June 2003 and 30 September 2003 for Mr Gawler and Mr Eilbeck respectively. At the request of the Chairman of the Remuneration Committee and in line with best practice, Mr Gawler agreed to reduce his notice period from the employer to 12 months with effect from 6 March

2003. However Mr Eilbeck has decided to retain his existing contractual rights in this regard until 30 September 2003 when the period of notice from the employer will automatically reduce to 12 months and the period of notice from the executive to 6 months.

- B.1.10 The executive directors' service contracts contain predetermined liquidated damages provisions as noted in the Remuneration Report on page 24.

Internal control

The board of directors has overall responsibility for the group's system of internal control and the Funding & Audit Committee has been delegated formal responsibility for reviewing the effectiveness of the system of internal control.

The processes to manage the key risks to the success of the group are reviewed and improved as necessary. The board has put in place an organisational structure with clearly defined lines of responsibility and delegation of authority and there are also established procedures for monitoring the group's businesses. While the operational control of the group is decentralised and responsibility is delegated, the operations are subject to the overall group internal control framework. This, by its nature, can provide only reasonable but not absolute assurance against material misstatement or loss.

As was announced on 27 January 2003, the Company became aware of certain accounting irregularities affecting one of its business units within the Air and Gas Handling business in North America. The Chairman ordered an in depth investigation into the matter and a team was despatched to North America, supported by external advisers, to assess the nature and scale of the irregularities. Three employees who have been involved in the matter have been dismissed.

The investigating team has found no evidence of misappropriation of assets and believes that the irregularities are confined to one business unit and have no wider consequence for the integrity of the Group's financial statements. Internal control procedures will be updated to reflect recommendations made by the investigating team and external advisers.

The key procedures that have been established and that are designed to provide effective internal control are:

Assessment of business risk

A system of risk assessment and identification and evaluation of controls is embedded within the management processes throughout the group. Strategic risks and opportunities arising from changes in the group's business environment are regularly reviewed by the executive directors and discussed by the board. Risks relating to key activities within the operating units and at head office are assessed on a continuous basis. Summary reports are made to the operating divisions and head office as appropriate.

Control environment

The board sets overall policy for the group and delegates the authority to implement that policy to its operating divisions and operating units. A well defined organisational structure with clear operating procedures, lines of responsibility and delegated authority has been established within the group. In terms of the group approval framework, there are procedures for appraisal, review and authorisation of investments and capital expenditure.

Information and communication

The group's operating procedures include a comprehensive system for reporting financial and non-financial information to the board, including:

- The preparation and review of annual budgets which are approved by the board.
- A review of the businesses at each board meeting, focusing on any new risks arising (for example, those relating to proposed major investments and key changes in the markets).
- Regular meetings of the executive directors with divisional management.

Control procedures

Detailed operational procedures are developed for each of the group's key activities that embody key controls. The implications of changes in law and regulations are taken into account within these procedures. Procedures are established to safeguard the group's assets and to ensure that all financial transactions are properly recorded. Accounting policies and practices are widely disseminated throughout the group. Any changes required as a result of the accounting irregularities referred to earlier will be promptly implemented.

Monitoring process

There are clear procedures for monitoring the system of internal controls. The significant components of these are:

- Each year, the managing director and finance director of each operating unit and operating division are required to review internal controls and to return a self certification internal control questionnaire to the group certifying compliance with group policies and procedures and confirming the effectiveness of internal control systems.
- The management of each operating division regularly reviews the risk assessments and controls over these risks for its division. Head office reviews the work of divisional management and in turn reports to the Funding & Audit Committee.
- The Funding & Audit Committee has specific responsibility for assessing the effectiveness of internal controls and monitors the process of assessing the internal controls across the group on behalf of the board.
- The Funding & Audit Committee reviews the process by which risks are identified and assessed and the effectiveness of controls over these risks are assessed by operating units, divisional management and head office.
- The Funding & Audit Committee reviews the effectiveness of financial internal control. This involves the review of the comprehensive planning and budgeting system, with the annual budget being approved by the board. Monthly results are reported against budget and revised forecasts for the full accounting period are prepared regularly as necessary. The results of the annual self-certification internal control questionnaire process are reviewed by the Funding & Audit Committee and, where potential problems are identified, appropriate actions are taken. Any reports by the external auditors are also considered.

The board confirms it has carried out a review of the effectiveness of the group's system of internal controls described above for the financial year and up to the date of this report in accordance with the guidance set out in Internal Control: Guidance for Directors on the Combined Code (the Turnbull guidance). The review encompassed operational, financial and compliance controls as well as risk management. The process used included the following elements:

- As part of their ongoing reviews of the businesses the executive directors and head office reviewed the effectiveness of strategic, operational and compliance internal controls and risk management. As appropriate this involved considering any reports on key risk areas (concentrating on significant changes in the risk profile) and controls, formulation of actions, policies and procedures to control risks and reviewing the actions being taken on problem areas identified.
- The board considered reports from the Funding & Audit Committee and the executive directors on these areas during the year and, at the time of approving the annual report and accounts, considered a summary of the assessments of the effectiveness of the key risks and controls identified that was prepared on behalf of the executive directors.

Statement of directors' responsibilities

Company law requires the directors to prepare accounts for each financial period which give a true and fair view of the state of affairs of the Company and the group and of the profit or loss of the group for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts;
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the group and to enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors have reviewed the effectiveness of the system of internal controls over the maintenance and integrity of the Charter plc website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Going concern and current liquidity

In the year to 31 December 2002, the group met its day-to-day working capital requirements through a £127 million syndicated revolving credit facility. In addition, it has in issue US private placement loan notes totalling £128.2 million ($206.3 million) and, as at 31 December 2002, net debt stood at £194.0 million (2001: £214.1 million).

Charter is discussing with its lending banks the renewal of its syndicated revolving credit facility which is due to expire on 31 July 2003. At present some £91 million of the facility is drawn, leaving a balance of £36 million undrawn and available. Whilst the terms of the renewal have yet to be agreed with the banks, the Company will need to reduce its debt significantly during the course of the next twelve months and plans to do this through planned asset disposals. The directors believe that disposals can be made both within a timeframe and at prices that will prove to be acceptable and ensure that the group is able to meet its obligations on an ongoing basis.

The Company has been informed by the agent bank that the outstanding issues should be capable of being satisfactorily resolved prior to expiry of the current facilities, but after receipt of an accountant's report commissioned by the banks. There can be no guarantee that the renewal negotiations will be satisfactorily concluded. However, in the light of the information currently available to them, the directors believe that the banks will continue to provide support on terms acceptable to the Company. On this basis, the directors consider it appropriate to prepare the accounts on a going concern basis. Should the banks not support the Company in this respect, adjustments would be necessary to record additional liabilities and to write down assets to their recoverable amount. Furthermore, additional provisions might need to be made in the group's and Company's balance sheets in respect of liabilities which are currently contingent. It is not practicable to quantify these possible adjustments.

Certain holders of the group's US private placement loan notes have informed the Company that they consider that a default has arisen under the loan notes as a result of the accounting irregularities which were announced by the Company on 27 January 2003 at one of the Air and gas handling units in North America. The directors' view, based on their knowledge of the situation and on advice by the Company's legal advisers, is that no default has occurred and the note holders have been advised accordingly. Of the total loan notes of $206.3 million, $72.3 million are due for scheduled repayment in March 2004 and the directors envisage that the terms of the renewal of the Company's banking facility will take account of the need to repay those notes in 2004. In the event that the Company's and its advisers' views are proven to be incorrect and the note holders elect to accelerate the notes, then the full amount of notes outstanding would become repayable immediately.