

Corporate governance

Introduction

The principal corporate governance guidance that applies to companies listed with the UK Listing Authority that is applicable to the year is contained in the 2003 Financial Reporting Council's Combined Code ("the Combined Code"). The Combined Code, which operates on a "comply or explain" basis, incorporates, amongst others, recommendations by the Higgs Review regarding the role of non-executive directors, and the Smith Review, which refers to audit committees. Through their commitment to the highest standards of corporate governance, the board endorses and supports the essential elements of the Combined Code and, apart from a few limited exceptions as described below, believes the Group has fully complied with the Combined Code during the year reported on. Where it has not, an explanation has been provided.

Compliance statement

The directors are committed to ensuring that the Company will work towards compliance with the provisions set out in Section 1 of the Combined Code.

The Company has been in compliance with the Code provisions set out in Section 1 of the Combined Code on corporate governance, except for the following:

- A.2.1. – division of roles – Upon the resignation of Anthony Hill on 23 February 2006, the Chairman, Kevin Loosemore assumed the roles of both non-executive Chairman and interim Chief Executive Officer until a replacement Chief Executive Officer was recruited. Following the appointment of Stephen Kelly as Chief Executive Officer on 1 May 2006, Kevin Loosemore reverted back to the role solely of non-executive Chairman on 21 May 2006, after a handover period.
- A.3.2. – board of directors – The Combined Code requires that at least half the board, excluding the Chairman, should comprise non-executive directors determined by the board to be independent. With two non-executive directors not regarded as independent, the Company was not able to comply with this rule during the year ended 30 April 2007. With the appointment of Paul Pester on 27 June 2007, the Company is closer to compliance.
- B.2.1. – remuneration committee – The Company is aware that the Chairman is not regarded as independent for the purposes of the Combined Code. The Code states that the remuneration committee must comprise at least three independent non-executive directors. With the appointment of Tom Skelton and Paul Pester as independent non-executive directors, it is planned that Kevin Loosemore will hand over the chairmanship of the committee before the end of the year and be in compliance.

- C.3.1. – audit committee – Similarly, the audit committee should comprise at least three independent non-executive directors. As the Chairman was not regarded as independent throughout the year this requirement was not met. With Paul Pester's appointment as a non-executive director and appointment to the audit committee, Kevin Loosemore resigned from the audit committee and the Company is now in compliance.

The principles set out in the Combined Code cover four areas: the board, directors' remuneration, accountability and audit and shareholder relations. With the exception of directors' remuneration (which is dealt with separately in the remuneration report on pages 26 to 31) the following section sets out how the board has applied these principles.

The board

The Group is controlled by the board, which is responsible for the Group's system of corporate governance. As at 30 April 2007, the board comprised eight directors:

Kevin Loosemore	Non-executive Chairman*
Stephen Kelly	Chief Executive Officer
Nick Bray	Chief Financial Officer
Mike Shinya	Chief Operating Officer
David Maloney	Non-executive director
David Dominik	Non-executive director
Prescott Ashe	Non-executive director
Tom Skelton	Non-executive director

* Kevin Loosemore served as interim Chief Executive Officer from 22 February 2006 to 21 May 2006.

Paul Pester was appointed a non-executive director on 27 June 2007.

The role of the non-executive directors is to ensure that independent judgement is brought to board deliberations and decisions. The non-executive directors possess a wide range of skills and experience, relevant to the development of the Company, which complement those of the executive directors.

The Chairman ordinarily operates in a non-executive capacity and is considered by the board to be independent of management and free from any business or other relationship which could materially interfere with the exercise of his independent judgement.

David Maloney, the senior independent non-executive director, and Tom Skelton and Paul Pester, non-executive directors, are considered by the board to be independent. Prescott Ashe and David Dominik are not

considered by the board to be independent by virtue of their positions with the Company's major shareholder, Golden Gate Capital.

In accordance with the Combined Code, all directors will be subject to election by the shareholders at the first AGM of the Company after their appointment, and, thereafter, at least every three years. Accordingly Tom Skelton, Mike Shinya and Paul Pester will be subject to election at the Company's AGM to be held on 26 September 2007. As the remaining non-executive directors were all elected to the board at the AGM of the Company in September 2005, the directors have agreed to offer themselves for re-election on a rotation basis. Accordingly, Kevin Loosemore retired voluntarily and was re-elected at the Company's AGM in September 2006 and David Maloney and David Dominik will be retiring voluntarily and submitting themselves for re-election by the shareholders at the AGM of the Company on 26 September 2007. The non-executive directors are appointed for specified terms. The board has agreed procedures for directors to follow if they believe they require independent professional advice in the furtherance of their duties and these procedures allow the directors to take such advice at the Company's expense. In addition, all the directors have direct access to the advice and services of the Company Secretary. The Company Secretary is accountable to the board through the Chairman on governance matters.

It is the responsibility of the Company Secretary to ensure that board procedures are followed and all rules and regulations are complied with. Under the direction of the Chairman, the Company Secretary's responsibilities include facilitating induction and professional development and ensuring the smooth flow of information within the board and its committees, and between non-executive directors and senior management. Any new director receives a comprehensive, formal and tailored induction into the Company's operations. Appropriate training is provided to new directors and is also available to other directors as required.

The terms of reference of the Chairman and Chief Executive Officer have been agreed with the board and, in accordance with best practice, their roles remain separate. Exceptionally, on 22 February 2006 the Chairman was additionally appointed interim Chief Executive Officer on the resignation of Anthony Hill, former Chief Executive Officer. Following the appointment of Stephen Kelly as Chief Executive Officer, the Chairman relinquished this additional appointment on 21 May 2006 and now remains solely the Chairman of the Company.

As part of its leadership and control of the Company, the board has agreed a list of items that are specifically reserved for its consideration. These include business strategy, financing arrangements, material acquisitions and divestments, approval of the annual budget, major capital expenditure projects, risk management, treasury policies and establishing and monitoring internal controls. At each meeting, the board reviews progress of the Group towards its objectives, and monitors financial progress against budget.

In the year to 30 April 2008, the board will meet, on a regular basis approximately every two months, with additional meetings when circumstances and business dictate. In months in which the board does not meet update calls are scheduled to review progress. A schedule of meetings has been established. All directors receive an agenda and board papers in advance of meetings to help them make an effective contribution at the meetings. In addition, the executive directors ensure regular informal contact is maintained with non-executive directors. The board makes full use of appropriate technology as a means of updating and informing all its members.

While the board retains overall responsibility for, and control of, the Company, day-to-day management of the business is conducted by the executive directors. Review of the Group's principal business activities is the responsibility of the executive management team, comprising the executive directors who are responsible for sales, marketing and finance, together with executives responsible for HR, legal, technology, development and customer care, who meet weekly.

The board receives papers on key subjects in advance of each board meeting. These typically cover:

- Strategy and budgets
- Business and financial performance
- Corporate activities
- Human resources
- Shareholders and city matters

The board has undertaken a formal and rigorous process for the evaluation of its own performance and that of its committees and individual directors (including the Chairman), as required by Combined Code provision A6.1. This process takes the form of questionnaires and personal interviews with the Chairman. The performance of the Chairman is reviewed by the non-executives.

The Chairman holds meetings with non-executive directors without the presence of executive directors.

Board committees

In accordance with best practice, the Company has established audit, nomination and remuneration committees, with written terms of reference for each that deal with their respective authorities and duties. The full terms of reference of all the committees are available from the Company Secretary or can be located on the Company's website. The Company is aware that the Chairman is not regarded as independent for purposes

Corporate governance

of the Combined Code. As a result of the appointment of Tom Skelton and Paul Pester as additional independent non-executive directors to the remuneration committee, it is planned that Kevin Loosemore will hand over the Chairmanship of the committee before the end of the year. Kevin Loosemore has ceased to be a member of the audit committee.

Audit committee

The audit committee is comprised entirely of non-executive directors of the Company. It is chaired by David Maloney, who the board considers has recent and relevant financial experience. The other members are Tom Skelton and Paul Pester. Kevin Loosemore was a member of the committee until 27 June 2007.

The audit committee has met five times during the financial year. The audit committee is responsible for reviewing the Group's annual accounts and interim reports prior to submission for approval to the full board. This committee also monitors the Group's accounting policies, internal financial control systems and financial reporting procedures. The audit committee provides a forum through which the Group's external and internal auditors report to the board. The auditors are invited to attend meetings of the committee on a regular basis and have the opportunity to meet privately with committee members in the absence of executive management. The audit committee oversees the relationship with the auditor, including the independence and objectivity of the auditor (taking into account UK professional and regulatory requirements and the relationship with the audit firm as a whole) and the consideration of audit fees and fees for other non-audit work. In addition, the audit committee has developed a policy designed to ensure that the auditor's objectivity and independence is not compromised by its undertaking inappropriate non-audit work. All significant non-audit work commissioned from the external auditor requires audit committee approval.

An outsourced internal audit function was established on 5 April 2006 through the appointment of KPMG LLP.

The audit committee will meet at least four times during the coming financial year (and, additionally as appropriate), and a schedule of meetings for the year has been established.

The audit committee's terms of reference include a process for employees of the Company to raise in confidence concerns about possible impropriety in matters of financial reporting or other matters.

The written terms of reference of the audit committee include, among other things, the following responsibilities:

- To report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken;

- To ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control;
- To monitor the integrity of the financial statements of the Company, including its annual and interim reports, preliminary results announcements and any other announcement relating to its financial performance;
- To review the consistency of, and changes to, accounting policies;
- To keep under review the effectiveness of the Company's internal controls and risk management systems;
- To review the Company's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters;
- To monitor and review the need for, and the effectiveness of, the Company's internal audit function in the context of the Company's overall risk management system; and
- To consider and make recommendations to the board in relation to the appointment, re-appointment and removal of the Company's external auditor.

Nomination committee

The nomination committee is comprised entirely of non-executive directors of the Company and has met three times during the financial year. The nomination committee will meet at least twice during the coming financial year. It is chaired by Kevin Loosemore and the other members are David Maloney and David Dominik.

The nomination committee is responsible to the full board for proposing candidates to the board, having regard to the balance and structure of the board. The nomination committee uses consultants to identify suitable candidates where a position is identified.

The terms of reference of the nomination committee include, among other things, the following responsibilities:

- To review the structure, size and composition of the board and make recommendations to the board with regard to any changes;
- To identify and nominate, for the approval of the board, candidates to fill board vacancies as and when they arise;
- To give full consideration to succession planning for directors and other senior executives; and

- To keep under review the leadership needs of the Group, both executive and non-executive, with a view to ensuring the continued ability of the organisation to compete effectively in the market place.

Remuneration committee

Details of the remuneration committee are described in the remuneration report on pages 26 to 31.

Accountability and audit

The board is responsible for the preparation of financial statements that present a balanced assessment of the Group's financial position and prospects. This responsibility is administered primarily by the audit committee, the terms of reference of which are referred to above.

Internal controls

The board is ultimately responsible for establishing and monitoring internal control systems throughout the Group and reviewing their effectiveness. It recognises that rigorous systems of internal control are critical to the Group's achievement of its business objectives, that those systems are designed to manage rather than eliminate risk and that they can only provide reasonable and not absolute assurance against material misstatement or loss.

The key elements of the control system are:

- The Group operates a structured, objectives-driven approach to fulfil its core purpose and goals in respect of sustained profitability and growth.
- Research and development and capital expenditure programmes are subject to formal review and monitoring procedures.
- All contracts are reviewed. The approval level of review depends on the size and complexity of the contracts and associated risks. There are formal limits above which the review level is escalated.
- Reconciliations are performed on a timely basis for all major accounts.
- Systems and procedures are in place for all major transaction types with appropriate authorisation controls.

There is an ongoing internal process for identifying, evaluating and managing the significant risks faced by the Company in association with the work performed by the outsourced internal audit function. This process has been in place throughout the year and up to the date of approval of the report and accounts.

As part of the process that the Company has in place to review the effectiveness of the internal control system, there are procedures designed to capture and evaluate failings and weaknesses, and in the case of those

categorised by the board as "significant", procedures exist to ensure that necessary action is taken to remedy the failings.

This requirement is set out in the audit committee's terms of reference to report on a regular basis to the board on the Group's internal financial control procedures and to make recommendations to the board in this area.

The external auditors provide a supplementary, independent and autonomous perspective on those areas of the internal control system which they assess in the course of their work. Their findings are regularly reported to both the audit committee and the board. To ensure auditor objectivity and independence there is a stringent process in place to approve non-audit work.

Human resources

The Group endeavours to appoint employees with appropriate skills, knowledge and experience for the roles they undertake. The Group has a range of policies which are aimed at retaining and providing incentives for key staff. Objectives are set for departments and employees that are derived from the Group's business objectives. The Group has a clear and well-understood organisational structure and each employee knows his or her line of accountability.

Announcements

All major announcements are approved by the Chairman and executive directors and circulated to the board prior to issue. The Group also has internal and external checks to guard against unauthorised release of information.

Financial

A comprehensive budgeting system allows managers to submit detailed budgets which are reviewed and amended by executive directors prior to submission to the board for approval.

Insurance

The Group keeps under review its portfolio of insurance policies with its insurance broker to ensure that the policies are appropriate to the Group's activities and exposures.

Corporate governance

Attendance at meetings

The number of board meetings and committee meetings attended by each director in the year to 30 April 2007 was as follows:

	Board		Audit committee		Remuneration committee		Nomination committee	
	Held*	Attended	Held*	Attended	Held*	Attended	Held*	Attended
Kevin Loosemore	12	12	5	5	8	8	3	3
Stephen Kelly	12	12	–	–	–	–	–	–
Nick Bray	12	12	–	–	–	–	–	–
Mike Shinya	2	1	–	–	–	–	–	–
David Maloney	12	12	5	5	8	8	3	3
David Dominik	12	8	–	–	–	–	3	3
Prescott Ashe	12	6	–	–	–	–	–	–
John Browett	4	2	2	1	4	3	–	–
Tom Skelton	7	6	3	3	3	3	–	–

* during period of appointment.

Note:

John Browett resigned 27 September 2006.

Tom Skelton was appointed 23 October 2006.

Mike Shinya was appointed 26 February 2007.

Shareholder relations

The Company values the views of shareholders and recognises their interests in the Group's strategy and performance.

The Company has historically reported formally to shareholders twice a year, around June (preliminary announcement of annual results) and December (interim statement). This shall remain the case going forward but, in addition, following the implementation of the Transparency Directive, the Company shall also be publishing interim management statements in or around August and February each year. The annual report is expected to be mailed to shareholders in August. Separate announcements of all material events are made as necessary. Regular

communications are maintained with institutional shareholders and presentations are given to shareholders when the half-year and full-year financial results are announced. In addition to the Chief Executive Officer and Chief Financial Officer, who have regular contact with investors, Kevin Loosemore, Chairman, and David Maloney, Senior Independent Director, are available to meet with shareholders as and when required. The whole board is kept up to date at its regular meetings with the views of shareholders and analysts. External analysts' reports are also circulated to directors.

The Company's website (www.microfocus.com) provides an overview of the business including its strategy, products and objectives.

All Group announcements are available on the website and new announcements are published without delay. The terms of reference of each of the board's three committees and other important corporate governance documents are available on the website and from the Company Secretary. Additionally, the Chief Financial Officer provides a focal point for shareholders' enquiries and dialogue throughout the year.

Annual General Meeting

The Company's AGM, which will be held on 26 September 2007, will provide an opportunity for the board to meet with all shareholders and participation of shareholders is encouraged. At the meeting, in addition to the statutory business, the board will be available for questions from shareholders.

In accordance with the Combined Code recommendations, the Company will count all proxy votes and will indicate the level of proxies lodged, the number of proxy votes for and against such resolution and the number of abstentions. A resolution will be proposed for each substantive issue and the Chairs of the audit, remuneration and nomination committees will attend to answer questions.