

# Corporate governance

## The Combined Code

The ordinary shares of the Company were admitted to the Official List and to the London Stock Exchange to be traded on its main market for listed securities, on 17 May 2005. The Company is committed to practising good corporate governance of its affairs as part of its management of relationships with its shareholders and other stakeholders.

## 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. As a private company for the whole of the year ended 30 April 2005, the provisions of the Combined Code did not apply to the Operating Group. Furthermore, the Company did not form part of the Group until after the Share Exchange had taken place on 17 May 2005 and did not seek to comply with the provisions of the Combined Code until it became a listed company on Admission. During the current financial year the board will assess its practices to ensure the Company works towards compliance with the Combined Code and will continue to monitor any changes required to be made to further develop and enhance its governance policies.

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 24 to 27) the following section sets out how the board has (since Admission) applied such 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 2005, the board comprised six directors:

Kevin Loosemore	Non-executive Chairman
Dr Anthony Hill	Chief Executive Officer
Richard Lloyd	Chief Financial Officer
David Maloney	Non-executive director
Prescott Ashe	Non-executive director
David Dominik	Non-executive director

Additionally, John Browett was appointed as a non-executive director on 1 July 2005.

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 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 John Browett, the recently appointed non-executive director, are also 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 within Golden Gate Capital.

All directors are required to retire and submit themselves for re-election at the Annual General Meeting within three years of their appointment and, thereafter, at least every three years. However, in accordance with the Combined Code, all directors will be subject to election by the shareholders at the first Annual General Meeting of the Company after their appointment and accordingly the directors will be subject to re-election at the Company's Annual General Meeting to be held on 28 September 2005. Subject to their re-election and Companies Act provisions, 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 Company has arranged directors' and officers' insurance on behalf of all the directors.

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.

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, particularly in respect of research and development projects, and monitors financial progress against budget.

In the year to 30 April 2006, the board will meet on a regular basis approximately every two months, with additional meetings when circumstances and business dictate. 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 senior management (comprising the executive directors, together with executives responsible for marketing, sales, HR and research) who meet fortnightly.

Due to the short period of time since Admission, the board has not 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. However, this process is being established and, during the course of the current year, will take the form of questionnaires and personal interviews with the Chairman.

It is intended that the Chairman will hold meetings with non-executive directors without the presence of executive directors as appropriate.

#### *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. The Company is aware that the Chairman is not regarded as independent for purposes of the Combined Code. It is planned that Kevin Loosemore will step down from the remuneration and audit committees when other independent non-executives are appointed to such committees.

#### *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 Kevin Loosemore and John Browett. The audit committee has met twice since Admission. The audit committee is responsible for reviewing the Group's annual accounts and interim reports prior to their submission for approval to the full board. This committee will also monitor 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 auditor reports to the board. The auditor will be invited to attend meetings of the committee on a regular basis and will 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 develops and recommends to the board 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.

As at 30 April 2005 there was no internal audit function. The audit committee will discuss the ongoing need for an internal audit function and, if established, will be responsible for agreeing the annual internal audit plan.

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It is intended that the audit committee will meet at least four times during the forthcoming year (and, additionally as appropriate), and a schedule of meetings for the year has been established.

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

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

- 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 once since Admission. It is chaired by Kevin Loosemore and the other members are David Maloney and David Dominik. The nomination committee will be responsible to the full board for proposing candidates to the board, having regard to the balance and structure of the board. In appropriate cases, recruitment consultants will

also assist in the process. The nomination committee will meet at least twice during the forthcoming year.

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*

The remuneration committee is comprised entirely of non-executive directors of the Company. It is chaired by Kevin Loosemore and the other members are David Maloney and John Browett. The remuneration committee has met once since Admission. The remuneration committee is responsible for reviewing remuneration arrangements for members of the board and for providing general guidance on aspects of remuneration policy throughout the Group. The remuneration committee will meet at least twice during the forthcoming year.

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

- To determine and agree with the board the framework or broad policy for the remuneration of the Company's Chief Executive Officer, Chairman, the executive directors, the Company Secretary and other members of the executive management (as appointed from time to time);
- To approve the design of salaries for senior managers, and determine targets for any performance-related pay schemes operated by the Company, and approve the total annual payments;

- To review the ongoing appropriateness and relevance of the remuneration policy;
- To review the design of all share incentive plans for approval by the board and shareholders;
- To determine the policy for, and scope of, pension arrangements for each executive director and other senior executives;
- To determine the total individual remuneration package of each executive director and other senior executives including bonuses, incentive payments and share options or other share awards; and
- To oversee any major changes in employee benefits structures throughout the Company or Group.

#### 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 for 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.

An ongoing process for identifying, evaluating and managing the significant risks faced by the Group is currently being implemented. The effectiveness of the Group's internal control systems will also be reviewed by the board during the year. The audit committee's terms of reference include the review of the Group's internal financial control systems. The audit committee will be required to report and make recommendations to the board in this area.

#### 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, the executive directors and a panel of senior executive management and then 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 has reviewed its portfolio of insurance policies with its insurance broker to ensure that the policies are appropriate to the Group's activities and exposures.

#### Attendance at meetings

The number of board meetings and committee meetings attended by each director in the period following Admission was as follows:

	Board		Audit committee		Remuneration committee		Nomination committee	
	Held	Attended	Held	Attended	Held	Attended	Held	Attended
Kevin Loosemore	4	4	2	2	1	1	1	1
Dr Anthony Hill	4	4	-	-	-	-	-	-
Richard Lloyd	4	4	-	-	-	-	-	-
David Maloney	4	3	2	2	1	1	1	1
Prescott Ashe	4	2	-	-	-	-	-	-
David Dominik	4	3	-	-	-	-	1	1
John Browett*	4	1	2	1	1	-	-	-

\*John Browett was appointed on 1 July 2005 and was therefore only available to attend two board meetings and one meeting of the audit committee.

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## **Shareholder relations**

The Company values the views of shareholders and recognises their interests in the Group's strategy and performance. The Company will report formally to shareholders twice a year, around July (preliminary announcement of annual results) and December (interim statement). The annual report will usually be mailed to shareholders in August. Separate announcements of all material events will be made as necessary.

Regular communications will be maintained with institutional shareholders and presentations will be 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](http://www.microfocus.com)) provides an overview of the business including its strategy, products and objectives. All Group announcements will be available on the website, and new announcements will be published without delay. The terms of reference of each of the board's three committees and other important corporate governance documents will be available from the Company Secretary. Additionally, the Group's corporate communications department and Chief Financial Officer provide a focal point for shareholders' enquiries and dialogue throughout the year.

## **Annual General Meeting**

The Company's first Annual General Meeting, which will be held on 28 September 2005, will provide an opportunity for the board to meet with all shareholders, and their participation is encouraged. At the meeting, in addition to the statutory business, the board will adopt a policy of holding business presentations to ensure that an up-to-date picture of the Group's activities is given, following which the board is available for questions from shareholders.

In accordance with the Combined Code recommendations, the Company will count all proxy votes and on each resolution, which is voted on a show of hands, the Company will indicate the level of proxies lodged, and 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.