

Corporate governance report

Combined code

The Board has prepared this report with reference to the UK Combined Code of Corporate Governance issued by the Financial Reporting Council as revised in June 2006. Throughout 2007/08 the Group has complied with the provisions set out in Section 1 of the Combined Code, with exceptions noted below, and applied the principles of the Code as described below.

In recent years, there have been significant developments in the Group's corporate governance structure. Since the acquisition of Safeway in 2004 the composition of the Board has changed significantly. Progress in the establishment of principles of best practice relating to governance has been and continues to be made.

During the year:

- >> membership to and the roles of the Executive Board, Property Board and Manufacturing & Distribution Boards were revised and formalised,
- >> the Group Marketing and Communications Director and Group HR Director were recruited to the top team,
- >> the Audit Committee has had regular reports on the status of internal control across the Group from the newly formed internal audit function.

Throughout 2007/08 the Group has complied with the Combined Code, except in the following areas:

Combined code provisions	Status	Explanation
A.3.2 – at least half the Board, excluding the Chairman, comprise independent Non-Executive Directors	At the beginning of the year there was one more Executive Director than Non-Executive Directors	As reported last year, the Board is committed to ensuring that independent Non-Executive Directors comprise at least half the Board during 2008
C.3.1 – at least one member of the Audit Committee has recent relevant financial experience	The current Audit Committee does not have a member with recent relevant financial experience	This is being addressed as part of overall Board composition and the previously reported arrangements remain in place to ensure the satisfactory operation of the Audit Committee.
C.3.4 – there are arrangements in place for the staff to raise concerns in confidence	Comprehensive whistle-blowing procedures did not exist throughout the period	Whistle-blowing procedures that include adequate reporting to the Audit Committee were introduced in February 2008

The Board

a) Membership

On 3 February 2008 the Board comprised a Chairman, five Executive Directors and five Non-Executive Directors. With the retirement of the Chairman and the planned recruitment of an additional Non-Executive Director, at least half of the Board will ultimately comprise of independent Non-Executive Directors. Details of appointments, roles and backgrounds are provided on page 34.

On 1 September 2007, Sir Ian Gibson joined the Group as Non-Executive Deputy Chairman. With the assistance of the Chairman and Company Secretary he has completed a period of induction where he met with the Directors and senior executives from across the Group, and visited stores and other operations across the business.

The role of the Deputy Chairman is a temporary role prior to succeeding Sir Ken Morrison as Chairman of the Group. The division of responsibilities between the Chairman and the CEO has been set out in writing by the Board.

b) Performance evaluation

In February 2007, an independent assessment was conducted to evaluate the performance of the Board, its committees and its Directors. The results of this were presented to the Board in March 2007. This confirmed that Board members felt that good progress had been made, and that the Board was embracing the right

programme of work to ensure further improvements in its effectiveness.

This assessment was followed up with another evaluation carried out in December 2007. The Board conducted this evaluation without external assistance through the use of a questionnaire, based on the independent assessment. The questionnaires were sent to all Directors and the responses were reviewed by the Chairman and the Company Secretary, and a report of findings was discussed by the Board. The Board was satisfied with its performance and it was agreed that action would be taken in those areas for which it believed improved processes could be introduced.

c) Senior Independent Director

Paul Manduca as the Senior Independent Director (SID) is available to shareholders as an alternative to the Chairman, CEO and the Group Finance Director. The SID ensures that he is available to meet shareholders during the year and reports any relevant findings to the Board or Chairman. He also chaired the Nomination Committee when it was considering the recruitment of the Deputy Chairman.

d) Non-Executive Directors

The Non-Executive Directors provide a varied range of skills and experience to the Group. The Board is satisfied that Sir Ian Gibson was independent at the time of appointment and all other Non-Executive Directors remain independent as defined by the Combined Code.

- >> has been employed by the Group within the last five years,
- >> has had a material business relationship with the Group within the last three years,
- >> receives remuneration other than Directors' fees,
- >> has close family ties with any of the Group's advisors, Directors or senior employees,
- >> holds cross-directorships or has significant links with other Directors through involvement in other companies or bodies,
- >> represents a significant shareholder,
- >> has served on the Board for more than nine years.

All Non-Executive Directors fulfilled the commitment of their engagement letters to provide a minimum time commitment based on one day per month attendance of meetings, attendance at the Annual General Meeting (AGM), Board away days and site visits, plus adequate preparation time. No Non-Executive Directors hold other positions that mean that they will not be able to fulfil these commitments or contribute to the governance and operations of the Group.

e) Board responsibilities

The Board is responsible for setting and approving the strategy and key policies of the Group, and for monitoring the progress towards achieving these objectives. It monitors financial performance, critical operational issues and risks. The Board also approves all circulars, listing particulars, resolutions and correspondence to the shareholders including the Annual report, half yearly financial report and interim management statements. The formal schedule of matters reserved for the Board remains unaltered and further details are available in the Investor Relations section of the Group's website www.morrisons.co.uk.

Operating Boards

The CEO has restructured the previous Executive Board and other Operating Boards into three bodies. The CEO and the Group Finance Director are members of all the following:

a) Executive Board

The Executive Board comprises four Executive Directors who oversee the day-to-day direction of the retail business. The Executive Board has met 16 times through the year. Examples of the matters brought to the Executive Board include store and product performance, brand management, food safety, marketing initiatives and the Group's corporate social responsibilities.

b) Property Board

The Property Board consists of four Executive Directors and has met monthly since its formation. This Board has oversight of the strategic development and operational management of the Group's property. Matters brought to this Board include development of new stores and facilities, refurbishments and extensions.

c) Manufacturing & Distribution Board

The Manufacturing & Distribution Board comprises two Executive Directors, the Manufacturing Director, the Distribution Director plus three other senior executives. This body has met monthly and

considers the strategic development of the Group's manufacturing and distribution functions.

Committees of the Board

The principal committees of the Board are the Audit, Remuneration and Nomination Committees.

Name	Committee membership		
	Nomination	Audit	Remuneration
Marc Bolland	X		
Brian Flanagan	X	X	X
Sir Ian Gibson	X		X
Paul Manduca	X	X	X
Sir Ken Morrison	X		
Susan Murray	X	X	X
Nigel Robertson	X	X	X

The Directors attended the following numbers of Board and Committee meetings:

	Board	Nomination	Audit	Remuneration
Number of meetings	16	5	6	12
Marc Bolland	16/16	5/5		
Brian Flanagan	15/16	5/5	5/6	11/12
Sir Ian Gibson	4/5	1/1		3/4
Mark Gunter	16/16			
David Hutchinson	7/8			
Martyn Jones	13/14			
Paul Manduca	15/16	5/5	6/6	9/12
Sir Ken Morrison	15/16	4/5		
Susan Murray	16/16	5/5	6/6	12/12
Roger Owen	15/16			
Richard Pennycook	16/16			
Nigel Robertson	14/16	5/5	4/6	10/12

The Company Secretary organises the appropriate level of insurance cover for Directors to defend themselves against legal claims and civil actions. The level of cover is currently £50m in aggregate.

a) Nomination Committee

The current membership of the Nomination Committee is shown in the table above detailing Board and Board committee membership. Sir Ian Gibson was appointed as a member on 17 September 2007.

During the year, the Committee put forward, for approval by the Board, the appointment of Martyn Jones as Group Trading Director and Sir Ian Gibson as Non-Executive Deputy Chairman. Martyn Jones was appointed to the Board on 8 March 2007, and Sir Ian Gibson on 1 September 2007.

The activities of the Committee are focused on recruiting a Non-Executive Director with recent and relevant financial experience. The executive search agency, Egon Zehnder, is employed to identify candidates which the Nomination Committee shortlists. Interviews are conducted by the Nomination Committee and meetings organised with other Executive Directors if appropriate, before a recommendation is made to the Board.

The Committee's terms of reference are subject to an annual review and are available on request, and on the Group's website www.morrisons.co.uk.

b) Remuneration Committee

The current membership of the Remuneration Committee is shown in the table above detailing Board and Board committee membership. Sir Ian Gibson was appointed as a member on 17 September 2007. The Committee's terms of reference are subject to an annual review and are available on request and on the Group's website www.morrisons.co.uk.

During the year, the Committee has continued to reshape remuneration packages to make them more performance related and to ensure the Group's ability to recruit, retain and motivate high calibre senior executives. This has included the introduction of a competitive suite of annual and long term incentives. The Long Term Incentive Plan 'LTIP' was granted approval at the AGM in May 2007. The initial grant under the LTIP was made on 24 May 2007.

During the year, the Committee received advice from its appointed advisers New Bridge Street Consultants LLP (NBSC) on all remuneration related matters, Jardine Lloyd Thompson in respect of pensions, and Ashurst in respect of Executive Directors' contracts. Since his appointment in June 2007, the Group Human Resources Director has also materially assisted the Committee in its deliberations.

During the year, NBSC and Hay Group provided advice on incentive arrangements for staff.

c) Audit Committee

The Board has delegated, to the Audit Committee, the responsibility for reviewing on its behalf:

- >> the integrity of financial reports,
- >> the effectiveness of the Group's internal control and risk management systems,
- >> the independence of the external auditors.

The Audit Committee's remit has not changed during the year. Full terms of reference are available on request and on the Group's website www.morrisons.co.uk.

The Audit Committee regularly considers the professional development needs of its members, and whether adequate technical information is being provided. Where necessary it will seek independent external advice at the Group's expense, with such arrangements made through the Company Secretary. Whilst the Audit Committee remains short of a member with recent and relevant financial experience, the Company Secretary has retained, at the request of the Audit Committee Chairman, the services of PricewaterhouseCoopers LLP to advise the Audit Committee at relevant times during the year.

There has been no change in the composition of the Audit Committee during the year and the roles of the members also remain unchanged. The Chairman, the CEO, the Group Finance Director, the Head of Risk and Internal Audit and other finance department representatives have attended meetings by invitation.

i) Overview of actions taken by the Audit Committee in discharging its duties

The Committee has received and reviewed reports and presentations from senior management to fulfil its terms of reference. To meet its responsibilities in this respect the Committee considered:

- >> interim and preliminary results announcements and interim management statements,
- >> the accounting principles, policies and practices adopted in the Group's financial statements,
- >> the potential effects of tax and pensions accounting and other significant judgmental and complex accounting issues dealt within the accounts,
- >> the impact of litigation and contingent liabilities on the Group.

The Audit Committee oversees the Group's relationship with the external auditors. To fulfil its responsibilities in respect of the independence and effectiveness of the external auditors, the Committee reviewed:

- >> the terms, areas of responsibility, duties and scope of the external auditors as set out in the engagement letter,
- >> the external auditors work plan for the Group and its subsidiaries,
- >> the audit fee and the extent of non-audit services provided by the external auditors.

The Committee reviewed the letter from KPMG Audit Plc confirming its independence and objectivity. The Board has a policy on the engagement of the external auditors to supply non-audit services, and the Committee reviewed the scope of non-audit services provided by the external auditors to ensure that there was no impairment of objectivity. Private meetings are held with the external auditors, without management present. The purpose of these meetings is to understand their views on the control and governance environment and management's effectiveness within it.

ii) Internal control

The Board is responsible for setting a system of internal control for the Group and reviewing its effectiveness. The control system is intended to manage rather than eliminate the risk of not meeting the Group's strategic objectives. Any such system can only provide reasonable, not absolute, assurance against material misstatement or loss.

The Board delegates to the Audit Committee the review of the effectiveness of the Group's internal controls and risk management systems. During the year the Committee did this by:

- >> receiving and considering regular reports from the internal audit function on the status of internal control and risk management systems across the Group. The Committee also reviewed the department's findings, annual plan and the resources available to it to perform its work,
- >> reviewing the external auditor's management letters on internal financial control,
- >> seeking reports from senior management on the effectiveness of the management of key risk areas,

>> monitoring the adequacy and timeliness of management's response to identified audit issues.

Specific matters that were considered by the Committee or the Board included the supply of contaminated fuel, and the temporary closure in Paisley of one store's delicatessen counter. In both cases the business moved quickly to reduce the effect on our customers and to resume normal business.

During the year, the Head of Risk and Internal Audit made recommendations to the Board that introduced a regular process of formal risk assessment as an integral part of planning and review for business operations and major projects. These recommendations were accepted by the Board. To support the Board's review, the Head of Risk and Internal Audit is introducing to the Group a new, formal and continual process for identifying, evaluating and managing the significant risks faced by the business.

The Board is satisfied that a continual process for identifying, evaluating and managing significant risks has been in place for the financial year and up to the date of this Annual report. To date, no material financial problems have been identified that would affect the results reported in these financial statements. The Board confirms that if significant failings or weaknesses had been identified during this review the Board would have taken the necessary steps to remedy them.

Shareholder relations

The CEO and the Group Finance Director meet regularly with analysts and institutional shareholders. The Investor Relations Director also maintains a programme of work that reports to the Board the requirements and information needs of institutional and major investors. This is part of the regular contact that the Group maintains with its institutional shareholders. All Directors, Executive and Non-Executive attend the AGM. The Chairs of the Audit, Nomination and Remuneration Committees are available to answer any questions. Additionally, the Group's brokers sought independent feedback from investors following the annual and interim results in 2007. This feedback was reported to the Board.