

## CORPORATE GOVERNANCE

### CORPORATE GOVERNANCE

The 2003 Annual Report discussed at length the Board's view on corporate governance, its importance, its role in your Company and how the Board expects to fulfil its obligations as well as giving a number of undertakings.

Corporate governance is constant. We continue to believe that good corporate governance is important, but that it must be balanced with the need to bring commercial and business experience to bear. Maintaining this balance is difficult as the complexity of the business environment changes and the level of corporate governance compliance work continues to expand.

In Ireland, 2004 saw the passing of the Companies (Auditing and Accounting) Act 2003. While parts of the Act have yet to be enacted it brings further onerous responsibilities on your Board some of which, in practical terms, are very difficult to meet.

2004 has seen significant change in your Board. In last year's Report, I discussed at length the structure and nature of the Paddy Power Board. The evolution that I referred to then has continued in 2004. John Corcoran, Edward McDaid and Ian Armitage retired from the Board. They all served your interests well and I again thank them on your behalf. In 2004 one new executive director, Breon Corcoran and one new non-executive director, Patrick Kennedy joined your Board. Since the year end we have appointed Brody Sweeney as non-executive director. He has already attended his first Board meeting and we expect him to make an excellent contribution in the years ahead.

There are corporate governance implications in the Board restructuring. Given the number of independent non-executive directors, it has not been possible to staff all the committees in accordance with best practice and some temporary appointments were put in place. This is discussed in further detail under Board Operations and Committees.

What follows represents our policy on corporate governance:

### BOARD COMPOSITION

It will be at the discretion of the Board itself to decide on the right number of directors for the business at any point. The majority of the Board should be non-executive and the majority of non-executives should be independent. The Board should comprise a mix of the necessary business skills required to provide the basic oversight of the management of the business and to contribute to the development and advancement of business strategy. Paddy Power is a specialist business and should always retain the betting industry nous that has been part of the fabric of its Board, both as a private and public company. The Board should also comprise high quality non-executives from the different geographic markets in which the Group operates.

What we want to ensure is that Board members have sufficient time to add real value to your Company. The regulatory obligations and the wider demands of this Board mean that it has been agreed that no non-executive director should hold more than three directorships of publicly quoted companies. The Chairman cannot be the chairman of any other publicly quoted company. It is also agreed that there should be no more than two Paddy Power directors

on the Board of any one other listed company. Executive directors should hold no more than one non-executive director position.

### TENURE

The current Board comprises a mix of founding directors and those who were recruited for the particular skill and experience they would bring to Paddy Power. The Company is going through a period of change. Of the seven non-executive directors currently serving on the Board, two have been members since the Company was launched on the Stock Exchange in 2000, reduced from five in 2003.

The Board decided that from the date of flotation all non-executive directors of Paddy Power would serve a maximum of two three-year terms. The Nominations Committee would retain the right, in special circumstances, to extend the tenure of any non-executive director for a further term, to an absolute maximum of nine years in total.

### THE NON-EXECUTIVE DIRECTORS' RESPONSIBILITIES

In addition to their statutory responsibilities as outlined in the Statement of Directors Responsibilities on page 28, it has been agreed by your Board that all directors will have three specific responsibilities:

- Attendance at Board meetings
- Membership of at least one Board sub-committee
- Role as a 'mentor' to a particular area of the business

## CORPORATE GOVERNANCE (CONTINUED)

Regular contact with each other, and availability to the Chairman and to the Chief Executive for advice and ideas, remain critical. To be an effective Paddy Power Board member means being an enthusiast for the business. Attendance at meetings is not sufficient. Active participation during formal Board and committee meetings is what matters.

The non-executive directors also meet once a year without their executive director colleagues or your Chairman.

In addition to the 'standard' roles, the Board felt it would be very beneficial if individual non-executive directors were in a position to act as a mentor to an individual or a team within the business on strategic issues they might face where the director involved would have relevant skills and experience. This is not about non-executives straying into operational affairs that are the business of management. It is about giving life to the Board's real desire to provide business counsel that can help grow the business and, with it, shareholder value. It is also a further check on the growing pressures on a Board to just supervise, dot i's and cross t's.

In that context, it is important too that non-executives do not feel either restricted by the corporate governance rules of engagement or feel that simple compliance with them will be sufficient to meet their obligations. That has never been the Paddy Power way and a commitment to corporate governance should not be interpreted as a change in our drive for innovation.

### THE CHAIRMAN'S ROLE

The Chairman is a non-executive director and carries the same responsibilities as all his non-executive colleagues. His role is wider of course. As well as conducting Board meetings and being a member of sub-committees, your Chairman is the one constant in the management of Board affairs.

The Chairman is responsible for the leadership of the Board, ensuring its effectiveness in all aspects of its role and setting its agenda. The Chairman is also responsible for ensuring that all directors receive accurate, timely and clear information. The Chairman facilitates the effective contribution of his non-executive colleagues and ensures constructive relationships exists between executive and non-executive directors. He is the guarantor of effective communications with shareholders.

Performance evaluation of the Board, its committees and its individual directors is undertaken annually. Your Chairman acts on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the Board and, where appropriate, appointing new members to the Board or seeking the resignation of directors.

While there may be a perception that Board business revolves exclusively around meetings, this is not the case. Board counsel must be available to senior management at all times. Your Chairman

is the normal source of such advice and encouragement, but by no means the only one. The need to source the most relevant expertise at short notice means that the Chairman must have regular contact with individual Board members to ensure that there is a seamless interaction between the senior executive team and the non-executive directors.

As Chairman, I also meet with the non-executive directors independently of the executive directors. I meet formally with the Chief Executive and the Finance Director at least once a fortnight to discuss all aspects of the business performance. I also have regular meetings with the Chief Executive and on an occasional basis, with him, I meet with other senior members of the management team.

### DIRECTORS' FEES

In July 2003, the standard non-executive fee was set at €40,000. It was agreed that chairs of committees would be paid an additional fee of €10,000 and that, as Chairman, I would receive an annual fee of €110,000. These figures were set for an eighteen month period until 31 December 2004. The Board has decided to retain the same fee levels for 2005. Given the increasing responsibilities carried by non-executive directors of publicly quoted companies, I would expect that there would be a marked increase in these fees from 2006.

## BOARD EFFECTIVENESS

Each director is expected to perform to the highest standards with regard to both their general contribution and their contribution through committees and mentoring.

It is my responsibility to ensure the performance of all directors. In addition to the formal Board meeting I have met with all directors individually to discuss their performance. The non-executive directors have also met without myself and the executive directors. David Power has conducted a detailed review of my performance with all directors the results of which have been discussed with me. In the absence of having a senior independent director David Power undertook the review as it was felt he was in the best position to do so. David was not appointed during my tenure and has had the benefit of serving under each of the chairmen of Paddy Power.

## BOARD OPERATIONS AND COMMITTEES

The Board holds at least nine full Board meetings each year. Each member sits on at least one committee and each non-executive director is also being asked to 'mentor' one part of the business where it is felt they could provide additional specialist advice to senior management. I expect all Board members to be available to me between meetings.

The composition of the Board committees as at 22 February 2005 is:

## REMUNERATION

Stephen Thomas (Chair); David Power; Fintan Drury.

## NOMINATIONS

Fintan Drury (Chair); Nigel Northridge; John O'Reilly; Stewart Kenny.

## AUDIT

Patrick Kennedy (Chair); David Power; Brody Sweeney.

## RISK MANAGEMENT

David Power (Chair); Ross Ivers; John O'Reilly; Nigel Northridge; Breon Corcoran.

## AUDIT COMMITTEE

The Audit Committee's responsibilities include:

- monitoring the integrity of the financial statements of the company
- reviewing the company's internal financial controls
- monitoring and reviewing the effectiveness of the Group's internal audit function
- making recommendations to the Board in relation to the appointment and removal of the Group's external auditors
- approving the remuneration and terms of engagement of the external auditor
- evaluating the performance of the external auditors, including their independence and objectivity
- approving non-audit services provided by the auditors in accordance with the group policy on non-audit services
- developing and ensuring compliance with the Group's policy on the provision of non-audit services
- reviewing arrangements by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters

The Audit Committee has unrestricted access to the Group's external auditors and internal auditors with whom it meets twice a year both with and without management.

## REMUNERATION COMMITTEE

The Remuneration Committee is primarily responsible for making recommendations to the Board on remuneration policy for the Group's executive directors and selected senior management. The report of the Remuneration Committee is set out on pages 36 to 37.

## NOMINATIONS COMMITTEE

The Nominations Committee is primarily responsible for recommending candidates to the Board for appointment as directors and ensuring that appropriate procedures are followed for all such appointments.

In appointing new directors the Committee agrees the preferred profile of the director with the Board as a whole and receives written recommendations from existing directors. Given the industry knowledge of the Board and the committee members, as well as their general commercial experience, it is felt that this approach is more effective than using either advertised search or recruitment agencies. The quality of directors found using this approach has been excellent and the Board believes this is the best method for your Company.

## RISK COMMITTEE

The Risk Committee is responsible for ensuring that policies in respect of betting risk are appropriate to a Group of Paddy Power's size, for monitoring that policies are being correctly applied and that the expertise and systems within the organisation are consistent with the level of risk undertaken.

**CORPORATE GOVERNANCE (CONTINUED)**

The attendance at Board and committee meetings by the directors is set out below:

	Note	Number of meetings held and attended by the directors				
		Board	Audit	Remuneration	Nominations	Risk
Number of meetings held in 2004:		9	5	4	5	4
Attended by:						
F Drury*		8		4	5	
N Northridge*		8			5	4
P Kennedy*	a.	5	4			
S Thomas*		8		4		
B Sweeney*	b.	N/A	N/A	N/A	N/A	N/A
D Power**	c.	8	3	4		4
S Kenny**		7			5	
J O'Reilly***		9			5	4
R Ivers***		8				4
B Corcoran***	d.	2				

\* Independent Non-Executive Director

\*\* Non-Executive Director

\*\*\* Executive Director

- a. Patrick Kennedy was appointed to the Board on the 23 March 2004 after which there were six Board meetings and he attended five of them. He also attended all four of the audit committee meetings held after he joined the Board.
- b. Brody Sweeney was appointed to the Board on 16 February 2005.
- c. David Power was appointed to the Audit Committee in June 2004, after which there were three meetings, all of which he attended.
- d. Breon Corcoran was appointed to the Board on 31 August 2004 after which there were two Board meetings and he attended both of them. He was appointed to the Risk Committee in January 2005.

As discussed, the Board is in a state of transition and the number of independent directors has increased substantially from last year such that the Board composition is now four independent directors (excluding the chairman) and five non-independent directors. Over the year three non-independent directors left the Board to be replaced by two independent directors.

No senior independent director has been appointed as the Board wishes to complete the appointment of new independent directors and give the new Board some time to consider this matter.

Given the small number of independent directors serving in 2004 it was not possible to populate the committees in accordance with the Combined Code at all times. Given the appointment made on the 16 February 2005 the committees will now be reviewed and adjusted as appropriate.

In respect of the Nominations Committee, which comprises four directors, two of which are independent directors, the Board believes that the balance of independence, industry knowledge and experience best suits the task at hand. The quality of their

work is reflected in the excellent quality of the appointments and no changes to the composition of this committee are planned.

**INTERNAL CONTROL**

The Combined Code annexed to the listing rules of the Irish Stock Exchange and the UK Listing Authority states that:

1. The Board should maintain a sound system of internal control to safeguard shareholders' investment and Group assets.

2. The directors should, at least annually, conduct a review of the effectiveness of the Group's system of internal control and should report to shareholders that they have done so. The review should cover all controls, including financial, operational and compliance controls and risk management. The directors have overall responsibility for the Group's system of internal control and have delegated responsibility for the implementation of this system to executive management. This system includes financial controls which enable the Board to meet its responsibilities for the integrity and accuracy of the Group's accounting records.

The Board has established a process of compliance which addresses the Board's responsibility to maintain, review and report on all internal controls, including financial, operational and compliance risk management.

The principal processes comprising the system of internal control are:

- Budgets are prepared for approval by executive management and inclusion in a Group budget approved by the Board.
- Expenditure and income are regularly compared to previously approved budgets.
- The Board establishes treasury risk policies as appropriate, for implementation by executive management. Compliance with risk limits is reported on daily by the risk management department and reviewed by senior management and internal audit.
- All material commitments for expenditure and payments are compared to previously approved budgets and are subject to prior approval by personnel designated by the Board of Directors.
- Regular financial results are submitted to and reviewed by the Board of Directors.
- The directors, through the Audit Committee, review the effectiveness of the Group's system of internal control.
- A security department, independent of operations, monitors the activities of the betting operations and the risk management division, including the verification of winning bets. An internal audit department undertakes internal control reviews throughout the organisation. The Head of this Department meets regularly with the Audit Committee and also presents annually to the Board.

A review of the effectiveness of the system of internal control was carried out during the year to 31 December 2004. The directors considered that the procedures necessary to implement the Turnbull guidelines on internal control in the Combined Code have been properly established.

#### RELATIONS WITH SHAREHOLDERS

The Group is committed to ongoing communication with its shareholders. The Group operates an investor relations section on the corporate website. This contains copies of investor presentations and annual reports as well as providing access to RNS statements and corporate press releases.

There is regular discussion between Group management and analysts, brokers and institutional shareholders, ensuring that the market is collectively informed on business operations. Visits to the Group headquarters are encouraged and tours of our retail outlets are undertaken regularly. All shareholders are encouraged to attend the Annual General Meeting where they are afforded the opportunity to question the Board.

#### COMPLIANCE

The directors confirm that the Company has complied throughout the accounting period with the provisions of the Combined Code, except as noted above.

#### CONCLUSION

In 2003 I set out in detail our views on corporate governance together with our policies. As anticipated, 2004 has proved to be a year of change for the Board. The Board is confident, having worked within these policies for a year, that they are appropriate to a business of our size and stature. There are a number of challenges to be dealt with in 2005 in both completing the Board and preparing for the new Irish legislation. Your Board will continue to review best practice in corporate governance and adapt our practices as appropriate.

Once again I invite you all to consider the above carefully, and encourage any shareholders who have questions relating to this Corporate Governance Statement to contact me by email at [fdrury@paddypower.com](mailto:fdrury@paddypower.com).