

Corporate Governance Report

General principles

The Board is firmly committed to high standards of corporate governance. During the year to 31 December 2005, the Company complied with the provisions set out in Section 1 of the Combined Code on Corporate Governance (July 2003), as detailed below and in the Remuneration Report.

Ethics and Business Integrity Policy

Carillion has a clear and unequivocal approach to business integrity and ethics which underlies the Group's values of openness, collaboration, mutual dependency, professional delivery, focus on sustainable, profitable growth and innovation. The policy requires Carillion to conduct its business to the highest ethical standards. It applies to all employees and the way Carillion delivers this policy is and will be reflected in the way the Group competes for business, through the quality and value of its work and through the reliability and reputation of its employees.

The policy is:

- business integrity: we do not give or accept bribes. We do not sanction or accept any illegal payments, allowances, or gifts-in-kind. We will investigate fully all alleged breaches. We will dismiss any employee who has breached this policy;
- mutual respect: we do what we say we will do. We treat our people fairly and with respect at all times, avoiding discrimination and bullying. We provide a safe and healthy working environment, and respect sustainable principles in all our dealings;
- trust: we engender trust within our work groups and companies, respecting diverse traditions and cultures. We respect the trust placed in us by others, not least when we are asked to take responsibility for aspects of their business or resources. We maintain and demand high professional standards and demand honesty and openness. We avoid conflicts of interest wherever possible, and we proactively declare any unavoidable conflicts for open scrutiny and resolution;
- legality: we respect the rule of law in all our dealings. We clearly communicate procedures for disciplining those who do not comply with the law or our standards and policies. We maintain a system for confidential reporting of breaches of our standards and policies; and
- human rights: we support the belief that human rights are universal and adhere to the principles of human rights in our operations. We support the United Nations Universal Declaration on Human Rights.

Our policy is carried into our business through a series of detailed procedures. They allow us to carry into practice our reputation for conducting business to the highest ethical standard which is essential to our relationships with customers, business partners, employees, shareholders and the public.

The Ethics and Business Integrity Policy and its implementation is reviewed annually by the Board.

Directors

The Board

The Company is led by a Board comprising three Executive and four Non-Executive Directors. Throughout 2005, the Chairman and the Non-Executive Directors comprised more than half of the Board and this continues to be the case. The Chairman and each of the Non-Executive Directors is considered to be independent of management. They each have wide areas of experience and have no business or other relationship that could materially interfere with their independent judgement. David Garman is the Senior Independent Non-Executive Director.

In accordance with the Combined Code, the Executive Directors' service contracts are terminable by one year's notice.

A detailed internal evaluation of the Board's corporate governance procedures and compliance was again conducted in 2005 by the Chairman in conjunction with the Company Secretary. The internal evaluation took into account the views of each of the Directors on (i) the role of Directors, (ii) the performance of the Board, the Chairman and the Non-Executive Directors, (iii) Board Committees, (iv) leadership and culture, (v) Corporate Governance (vi) Directors' remuneration, (vii) relations with shareholders and (viii) Board accountability and audit. The Board at its meeting in October 2005 reviewed the results of the internal evaluation and, where required, issues were acted upon in order to further enhance the effectiveness of the Board's procedures and working practices.

This is the fourth year that this process has taken place and will be repeated annually as the Board considers it satisfactory. In addition, reviews of the performance of each of the Directors has taken place.

The division of responsibilities between the Chairman and the Chief Executive has been agreed by the Board and encompasses the following parameters:

- the primary job of the Chairman of a public company is to provide continuity, experience and governance while the Chief Executive provides leadership, energy, imagination and the driving force;
- the Chairman is viewed by investors as the ultimate steward of the business and the guardian of the interests of the shareholders. Nonetheless, it is essential that the outline of their respective roles encourages the Chairman and Chief Executive to work well together to provide effective and complementary stewardship;
- the Chairman must:
 - take overall responsibility for the composition and capability of the Board;
 - consult regularly with the Chief Executive and be available on a flexible basis for providing advice, counsel and support to the Chief Executive;
- the Chief Executive must:
 - manage the Executive Directors and the Group's day to day activities;
 - prepare and present to the Board strategic options for growth in shareholder value;
 - set the operating plans and budgets required to deliver the agreed strategy;
 - ensure that the Group has in place appropriate risk management and control mechanisms.

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The Board usually has a programme of seven meetings during the year and also meets on an ad hoc basis as required. A formal schedule of matters reserved to the Board for consideration and decision is maintained. These matters include:

- statutory matters such as the approval of final and interim financial statements and the recommendation of dividends;
- appointments to and removals from the Board and the terms of reference and membership of Board committees;
- approval of Group strategy and annual budgets;
- approval of authority levels, financial and treasury policies;
- authorisation for any acquisition or disposal;
- review of the internal control arrangements and risk management strategies; and
- review of corporate governance arrangements.

All Directors have access to the Company Secretary, who is responsible to the Board for ensuring that agreed procedures and applicable rules and regulations are observed. The Board approves the appointment and removal of the Company Secretary.

Any Director may, in furtherance of his duties, take independent professional advice when necessary, at the expense of the Company. No such advice was sought during the year.

The Board is provided with regular and timely information on the financial performance of businesses within the Group, and of the Group as a whole, together with reports on trading matters, markets, sustainability and other relevant issues.

Board Committees

The principal Board committees are the Remuneration Committee, the Audit Committee and the Nominations Committee. The Company Secretary acts as secretary to each of these committees. The terms of reference of each of the Board committees are available on the Carillion website at www.carillionplc.com or on request from the Company Secretary.

The membership of each of the principal committees is as follows:

Remuneration Committee

David Garman, Chairman
David Maloney
Vanda Murray

The Committee consists entirely of independent Non-Executive Directors and has a key role in reviewing and advising the Board on the appropriate remuneration for the Executive Directors of Carillion plc. Further details on remuneration issues are given on pages 35 to 41.

Audit Committee

David Maloney, Chairman
David Garman
Vanda Murray

This Committee consists entirely of independent Non-Executive Directors. For further information see the Report of the Audit Committee on page 32.

Nominations Committee

Philip Rogerson, Chairman
David Garman
David Maloney
John McDonough
Vanda Murray

The Committee reviews the structure, size, composition, balance of skills, knowledge and experience of the Board and makes recommendations to the Board with regard to any changes that are deemed desirable. The Committee also reviews succession planning to ensure that processes and plans are in place with regard to both Board and senior appointments.

Sir Neville Simms was Chairman of the Nominations Committee until he retired from the Board on 11 May 2005. Both Andrew Parrish and Roger Dickens served on the Remuneration, Audit and Nominations Committees during the year under review until they stood down as a Directors on 11 May and 2 December 2005 respectively.

Attendance at meetings in 2005

The number of full scheduled Board and Committee meetings attended by each Director during 2005 was as follows:

	Board	Audit Committee	Remuneration Committee	Nominations Committee
Number of meetings held	8	4	2	4
Roger Dickens****	2	2	0	0
David Garman	8	4	2	4
Chris Girling	8			
John McDonough	8			
David Maloney***	1	1	1	
Vanda Murray**	4	2	1	2
Andrew Parrish*	3	2	1	1
Roger Robinson	8			
Philip Rogerson	8			3
Sir Neville Simms*	2			1

* Retired 11 May 2005
** Appointed 1 June 2005
*** Appointed 1 November 2005
**** Retired 2 December 2005

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Other Board matters

Policy on external appointments

Recognising that external appointments can broaden their knowledge and so be of benefit to the Company, Executive Directors are permitted, at the discretion of the Board, to accept a limited number of such appointments and retain the fees received for such appointments. John McDonough was a Non-Executive Director of Exel plc until he retired from the Board on 13 December 2005 following that company's takeover. Chris Girling is a Non-Executive Director of Elementis plc.

Nomination and remuneration of Directors

The appointment of a Director is a matter for resolution by the Board as a whole, taking advice from the Nominations Committee.

For the Board appointments made in 2005, the Nominations Committee used the services of executive recruitment consultants, Odgers Ray & Berndtson. Details of potential candidates were provided by Odgers Ray & Berndtson and initially reviewed by a sub-committee of the Nominations Committee. Meetings with selected candidates were then held with Directors. Subsequently, the Nominations Committee met to recommend appointments which were then approved by the Board.

In the case of Non-Executive Directors, initial appointments are for three years; reappointment is subject to review and is not automatic.

The fees of Non-Executive Directors are determined by the Board as a whole, taking into account the commitment required and participation in the work of committees and other advisory services in relation to the business of the Group. In advising the Board on such fees, it is the policy of the Executive Directors to seek independent external advice concerning the appropriateness of the amounts by comparison with general practice. The level of fees currently payable to the Non-Executive Directors is based on independent external advice.

The remuneration of the Directors is dealt with in the Remuneration Report on pages 35 to 41.

Retirement of Directors by rotation

All Directors are required to submit themselves for re-election at least every three years. The Director retiring and seeking re-election at the Annual General Meeting to be held on 10 May 2006 is Roger Robinson.

Additionally, new Directors are subject to election by shareholders at the first opportunity following their appointment. Accordingly, Vanda Murray and David Maloney will seek election at the 2006 Annual General Meeting.

The service contracts of the Executive Directors and the terms and conditions of appointment of the Non-Executive Directors are available for inspection at the registered office of the Company during normal business hours on any weekday (bank holidays excepted) and at the Annual General Meeting.

Induction and development of Directors

Directors are provided with a comprehensive information pack on joining the Company and are advised of their legal and other duties and obligations as a Director of a listed company. In addition, all new Directors receive induction on their appointment covering such matters as the operation and activities of the Group, the role of the Board, the Company's corporate governance procedures and social, environmental and ethical (SEE) matters. Directors are also briefed by the Company's external advisors, where appropriate, on changes to legislation or regulation or market practice as well as receiving briefings from business groups throughout the year.

At least once a year, the Board visits an operational site and in October 2005 the Directors visited the Group's operations in Canada. Directors are also encouraged to visit other operations and staff.

The regular updating of Directors' skills and knowledge is encouraged and a procedure has been established whereby the Company Secretary is notified by Directors of their requirements in this respect.

Relations with shareholders

In addition to communicating with shareholders generally from time to time, the Executive Directors and the Director of Group Corporate Communications meet regularly with representatives of major shareholders in order to foster the mutual understanding of objectives. The details of these meetings are reported to the Board. The Chairman is available for meetings with representatives of major shareholders as required.

Private and institutional shareholders are encouraged to attend the Company's Annual General Meeting.

The Company complies fully with the provisions of the Combined Code in respect of the notice, content of agenda and conduct of its Annual General Meetings. The Chairmen of the Remuneration and Audit Committees will be present at the Annual General Meeting on 10 May 2006 to respond to shareholders' questions.

Accountability and Audit

Report of the Audit Committee

The Audit Committee consists entirely of independent Non-Executive Directors:

David Maloney, Chairman
David Garman
Vanda Murray

David Maloney is an accountant who previously held a number of senior finance posts including Chief Financial Officer for Le Meridien Hotels and Resorts, Chief Financial Officer for the Thomson Travel Group (Holdings) plc and Group Finance Director of Avis Europe plc. David was appointed to the Audit Committee in December 2005.

David Garman is Chief Executive of TDG plc and was appointed to the Audit Committee in October 2004.

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Vanda Murray is a Director of Ultraframe plc. Vanda was appointed to the Audit Committee in July 2005.

Appointments to the Committee are made by the Board.

The Audit Committee has in attendance at meetings, by invitation of the Committee, Executive Directors, representatives of the external auditor, (KPMG Audit Plc), the Group Head of Risk and the Head of Internal Audit. It is also able to invite others as it requires from time to time. The Committee also meets privately with both the external and internal auditors.

The responsibilities of the Audit Committee include:

- the review of the annual and interim financial statements;
- consideration of the impact of changes to accounting regulations and the financial and accounting policies of the Carillion Group;
- compliance with statutory and other external requirements;
- reviewing the role of the internal audit function and the results of its audit work and the response of management;
- reviewing the scope and results of the external audit and its cost-effectiveness;
- ensuring that the internal and external audit functions are complementary;
- monitoring the independence and objectivity of the external auditor and ensuring that the services provided (including non-audit services) provide a proper balance between objectivity and value for money;
- recommending to the Board the external auditor to be proposed to shareholders for appointment.

The Committee is authorised by the Board to (i) seek any information necessary to fulfil its duties (ii) call any member of staff to be questioned at a meeting of the Committee as and when required and (iii) obtain external professional advice, at the Company's expense, which might be necessary for the fulfilment of its duties.

The members of the Committee receive fees as Non-Executive Directors which also reflect their membership of the Audit Committee and other Board committees. See page 36 for details.

Main activities of the Audit Committee in the year to 31 December 2005

Financial statements

The Audit Committee reviews and discusses with management and the external auditors the annual and interim statements. In this context, the Committee also reviews the written reports of KPMG on issues arising from the annual audit and the review of the interim results.

Internal controls

The Board is ultimately responsible for the Group's system of internal control. This responsibility includes clearly determining the control environment and reviewing annually the effectiveness of the internal control system. However, such a system can provide only reasonable and not absolute assurance against material misstatement or loss. In accordance with the Turnbull Guidance for Directors *Internal Control: Guidance for Directors on the Combined Code*, the Board

confirms that there is an ongoing process for identifying, evaluating and managing the significant risks (both financial and non-financial and including Corporate Social Responsibility risks) faced by the Group (including joint ventures and overseas businesses). The process has been in place for the year under review and up to the date of approval of the Annual Report and Accounts and is regularly reviewed by the Board.

Assurance over the design and operation of internal controls across the Group is provided through a mix of techniques:

- Internal Audit carries out audits to assess the adequacy and effectiveness of internal controls over the key risks faced by the business and reports its findings to management, the Executive Directors and the Audit Committee. The Audit Plan is presented to and approved by the Audit Committee annually;
- recommendations to improve the system of control are made by Internal Audit. The implementation of these recommendations is followed up and reported on quarterly;
- Internal Audit independently reviews the risk identification procedures and control processes implemented by management;
- a process of Control Risk Self-Assessment is used in the Group where Directors and senior managers are required to detail and certify controls in operation to ensure the control environment in their business areas is appropriate. They also confirm annually, in writing, that risk management processes and appropriate controls are in place and are operating effectively; and
- Internal Audit advises on aspects of the design and application of internal controls in key business projects and on policy and procedure changes.

Internal Audit reports to the Audit Committee on a regular basis. The Audit Committee reviews the assurance procedures and ensures that the level of confidence required by the Board is obtained. It also ensures the financial reporting process is credible and reliable. The Audit Committee presents its findings to the Board regularly and the Head of Internal Audit has direct access to the Audit Committee members.

An internal appraisal of Internal Audit was carried out during 2004 to ensure that it continued to meet the needs of its stakeholders and fulfill its governance role. This exercise involved extensive consultation across the Carillion Group. As a result, minor amendments to the resourcing and processes of Internal Audit were implemented in 2005.

Risk Management

The Group Head of Risk is responsible for advising on strategic risk issues across the Group, and for oversight of risk training. The Group Head of Risk is also responsible for carrying out an independent appraisal of all projects before submission to the Major Projects Committee (see page 34). This appraisal ensures that the differentiating factors of the Group's offer have been properly identified so maximising the opportunities available; it also involves ensuring that all inherent and residual risks associated with the project have been properly identified and considered.

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In addition, the Risk Forum, a committee of risk professionals from each of the business groups, meets on a quarterly basis to assess the strategic risks facing the Carillion Group. The conclusions of the Risk Forum are reported to the Audit Committee.

The Major Projects Committee, a committee of the Board, acts as the sanctioning body for major commitments and transactions including capital expenditure, major contracts and company and business acquisitions and disposals. This committee has delegated authority up to specified levels, beyond which Board approval is required.

Practical guidance for all staff is maintained in Group policy and procedure documents regarding the authorisation levels for commitments, contract selectivity and bidding, the provision of guarantees, management accounting as well as reporting and resolution of suspected fraudulent activities. Wherever possible, the Board operates a policy of prosecuting individuals found to have defrauded the Company or its subsidiaries. Learning points for management are identified and action plans implemented to minimise the recurrence of fraud.

Employees are encouraged to raise genuine concerns about malpractice at the earliest possible stage and a confidential 'whistleblowing' hotline provided by an independent third party is available.

Management is responsible for the identification and evaluation of significant risks applicable to its areas of business together with the design, operation and monitoring of suitable internal controls. These risks are assessed on a continual basis and may be associated with a variety of internal or external sources, including control breakdowns, disruption in information systems, competition, corporate social responsibility, natural catastrophe and regulatory requirements. Management is also responsible for timely and accurate reporting of business performance and for ensuring compliance with the policies set by the Board in its areas of business. Regular performance review meetings are held where management reports to the Executive Directors on business performance, risk and internal control matters. The results of these meetings are presented to the Board.

The Executive Directors report to the Board on material changes in the business and the external environment that affect significant risks. The Finance Director provides the Board with regular financial information, which includes key performance indicators and a summary of risk. Where areas for improvement are identified, the Board considers the recommendations made both by the Executive Directors and by the Audit Committee.

This report is reviewed and approved by the Audit Committee.

Audit independence

The Audit Committee and Board place great emphasis on the objectivity of the Group's auditor, KPMG Audit Plc, in their reporting to shareholders.

The KPMG audit director and manager are present at Audit Committee meetings to ensure full communication of matters relating to the audit.

The overall performance of the auditor is reviewed annually by the Audit Committee, taking into account the views of management, and feedback is provided to senior members of KPMG unrelated to the audit. This activity also forms part of KPMG's own system of quality control. The Audit Committee also has discussions with the auditor, without management being present, on the adequacy of controls and on any judgmental areas. These discussions have proved satisfactory to date.

The scope of the forthcoming year's audit is discussed in advance by the Audit Committee. Audit fees are reviewed by the Audit Committee after discussions between the businesses and the local KPMG offices and are then referred to the Board for approval. Rotation of audit director's responsibilities within KPMG is required by their profession's ethical standards. The current audit director responsible for the Carillion engagement is in his first year of signing the report following appointment at the 2005 Annual General Meeting. There is also rotation of key members within the audit team.

Assignments awarded to KPMG and its associates have been and are subject to controls by management that have been agreed by the Audit Committee so that audit independence is not compromised. In summary, the procedures are:

- audit related services: as auditor this is the main area of work of KPMG and its associates. If any additional accounting support is required then this is considered competitively;
- tax consulting: in cases where they are best suited, Carillion uses KPMG and its associates but the Group also uses other tax consultancies. Significant pieces of tax work are evaluated competitively;
- general and systems consulting: all significant consulting projects are subject to competitive tender.

Other than audit, the Group Finance Director is required to give prior approval of work carried out by KPMG and its associates in excess of a predetermined threshold; part of this review is to determine that other potential providers of the services have been adequately considered.

These controls provide the Audit Committee with adequate confidence in the independence of KPMG in their reporting on the audit of the Group.

Health and safety

A review of the Group's progress on health and safety, environmental and social performance is contained in the Corporate Social Responsibility section on pages 26 to 27.

R F Tapp
Secretary
8 March 2006