

Corporate Governance

Compliance with the Combined Code

The Board is committed to and has long recognised the importance of high standards of Corporate Governance. The Board is accountable to the company's shareholders for good governance and this statement describes how the Board applies the principles of good governance set out in the Combined Code (as appended to the Listing Rules of the Financial Services Authority) and the revised Combined Code ("2003 Combined Code") that has applied to the Company with effect from 1 January 2004.

The Board

As at 31 December 2004, the Board of Directors was made up of 7 members comprising the Executive Chairman, two executive Directors and four non-executive Directors, who have been collectively responsible for the success of the Group. Mr. Anthony Collins, Deputy Chairman, is Senior Independent Director. Directors' biographical details are set out on page 19. The Directors of the Group have extensive knowledge of the builders merchanting, DIY and mortar manufacturing businesses which are operated by the Group in the UK and Ireland.

The Board routinely meets six times a year and additionally as required by time critical business needs. There is also contact with the Board between meetings as required in order to progress the Group's business. The Board takes the major decisions while allowing management sufficient scope to run the business within a centralised reporting framework. The Board has a formal schedule of matters specifically reserved for its decision. This covers the key areas of the Group's business including financial statements, budgets, acquisitions, major items of capital expenditure and the development of the Group. The Boards' responsibilities also include ensuring that appropriate management, development and succession plans are in place; reviewing the environmental, health and safety performance of the Group; approving appointments to the Board and the Company Secretary; approving policies relating to Directors' remuneration and the severance of Directors contracts and insuring that satisfactory dialogue takes place with shareholders.

Directors have access to the advice and services of the Company Secretary who is responsible for advising the Board through the Chairman on all governance matters. The Company's Articles of Association and Schedule of Matters reserved for the Board for decision provide that the appointment or removal of the Company Secretary is a matter for the full Board.

Directors have full and timely access to all relevant information in a form appropriate to enable them to discharge their duties. Reports and papers are circulated to Directors in preparation for Board and committee meetings. The non-executive Directors, together with the executive Directors, also receive monthly management accounts, reports and information which enables them to review the performance of the Group on an ongoing basis.

Directors have access to independent professional advice at the Group's expense where they consider that advice is necessary to enable them to discharge their responsibilities as Directors.

The Board also periodically holds meetings at Group locations and periodically meets senior management of the Group's businesses in order to help the Board gain a deeper understanding of the Group's operations and markets.

The Board continues to hold the view that there remains a compelling commercial benefit to the Group and its shareholders in the combining of the role of Chairman and Chief Executive, and the holding of that combined office by Mr. Michael Chadwick. The combination of the roles are balanced from a governance point of view by the strong input of the non-executive Directors on the Board and the Board's committee structure.

Directors' Independence and Board Balance

It is Board policy that the Board should include a balance of executive and non-executive Directors such that no individual or small group of individuals can dominate the Board's decision making.

One non-executive Director, Mr. Norman Kilroy, is a former Managing Director of the Group. Three non-executive Directors, Mr. Anthony Collins, Ms. Gillian Bowler and Mr. Richard Jewson are considered by the Board to be independent of management and free from any relationship which could materially interfere with the exercise of their independent judgement. The Board has therefore determined all three Directors to be independent.

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Mr. Collins was appointed to the Board in 1988 and both Ms. Bowler and Mr. Jewson were appointed to the Board in 1995. The length of their service on the Board exceeds nine years and the 2003 Combined Code provides that an explanation be made to shareholders concerning their continued independence. The Board considers that the integrity and independence of these Directors are beyond doubt. All three Directors are financially independent of the company and have other significant commercial commitments. Over the past ten years Grafton Group plc has grown from its small mainly Irish base to being the leading player in the Irish merchanting and DIY markets and the fourth largest builders merchanting business in the UK market. The three non-executive Directors have made a valuable and unique contribution to the Board during this period of growth. Each of these non-executive Directors brings her/his own senior level experience gained in their own field of international business and professional practice. Their experience and long-term perspective on the Group's business provides the Board with stability and an invaluable resource during a time of significant development and opportunity following completion of the Heiton transaction, the Group's largest ever acquisition, earlier this year.

The Company's Articles of Association provide that one third of the Directors retire by rotation each year and that each Director seek re-election at the Annual General Meeting every three years. Additionally, new Directors are subject to election by shareholders at the first opportunity after their appointment. It is the Board's policy that non-executive Directors are normally appointed for an initial period of three years, which is then reviewed.

It is Board Policy that non-executive Directors who have served on the Board for more than nine years will retire annually and will offer himself/herself for re-election in cases where it is proposed to exceed nine years.

Mr. Collins retires by rotation at the AGM on 9 May 2005 and will seek re-election. Ms. Bowler and Mr. Jewson will resign and offer themselves for re-election at the AGM on 9 May 2005 in accordance with Board policy.

The Board recognises that the number of independent non-executive Directors is less than half of the members of the Board. Mr. Leo Martin, former Chief Executive of Heiton Group plc, was appointed to the Board as an executive Director on 7 January 2005 on completion of the acquisition of Heiton Group plc. The overall balance of the Board is currently under review and, as already announced, the Board is in the process of appointing two additional non-executive Directors. These appointments will reflect the scale and geographical spread of the Group's interests.

Mr. Norman Kilroy, who retired as Managing Director in April 2004, is a non-executive Director and will retire from the Board on 31 August 2005. The Board will manage the orderly succession of non-executive Directors over the coming years to sustain the effectiveness of the Board and its committees.

Induction and Training

It is the policy of the Board that formal induction is offered to all Directors appointed to the Board. This includes on-site visits and briefings from executive Directors and the Company Secretary. Induction covers matters such as the operations of the Group, the role of the Board and matters reserved for its decision, powers delegated to Board committees, corporate governance policies and the latest financial information about the Group. Directors are advised on appointment of their legal and other duties and obligations as Directors of a listed company.

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Evaluation of Board

The Board has put in place procedures which will involve the conduct of an annual evaluation process to periodically assess its performance, the performance of Board committees and individual Directors and to identify areas in which the effectiveness of the Board might be improved. This is achieved through annual discussion between each Director and the Senior Independent Director. The results of the evaluation process is presented to the Board for consideration of the issues identified.

Succession Planning

The Board plans for succession with the assistance of the nomination committee. The Board believes that it is necessary to have appropriate executive Director representation on the Board and sufficient non-executive Director representation to reflect the scale and geographic spread of the Group's operations.

Communication with Shareholders

The Company recognises the importance of communication with shareholders. Presentations are made to both existing and prospective institutional shareholders principally after the release of interim and annual results. In addition to the annual and interim results, the Group issues development updates twice yearly and a trading update at the Annual General Meeting. Major acquisitions are also notified to the market and the Company's website www.graftonplc.com presents information about the Group including interim and annual results and other announcements. The Chairman gives feedback to the Board on contacts with institutional shareholders and brokers' reports on the Group are circulated to all Directors. Non-executive Directors are offered the opportunity to attend meetings with major shareholders. The Annual General Meeting is normally attended by all Directors and shareholders are invited to ask questions during the meeting and to meet with Directors after the formal proceedings have ended. The Senior Independent Director is available to meet with shareholders if they have concerns which have not been resolved through the normal channels of Chairman or Finance Director or where such contacts are not appropriate.

Board Committees

The number of full Board meetings and committee meetings attended by each Director during 2004 was as follows:

	Board	Audit	Finance	Remuneration	Nomination
Number of Meetings	8	3	38	6	5
M. Chadwick	8	-	37	-	5
C. O'Nuallain	8	-	36	-	-
J. F. Malone	7	-	-	-	-
A. E. Collins	8	3	-	6	5
G. Bowler	7	3	-	6	5
R. W. Jewson	7	3	-	6	4
N. D. Kilroy	6	-	-	-	-

Mr. C. Rinn was appointed to the Finance Committee in March 2004 and attended all 28 meetings of the Committee following his appointment.

The Independent non-executive Directors met during the year both with and without the Chairman present to evaluate his performance. The Board is assisted by committees of Board members which focus on specific aspects of its responsibilities. The terms of reference of the Audit Committee, Remuneration Committee and Nomination Committee were approved by the Board and comply with the 2003 Combined Code and are available from the Company Secretary and can also be found on the company's website at www.graftonplc.com. Membership of the various committees is shown on page 19. The Company Secretary was recently appointed as secretary to all three Board Committees.

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Audit Committee

During the year the Audit Committee comprised Richard W. Jewson, who chairs the committee, Gillian Bowler and Anthony Collins. All members of the committee are determined by the Board to be Independent non-executive Directors. The Audit Committee met three times during the year.

Mr. Richard Jewson brings to the Committee recent and relevant financial experience. The Board is satisfied that the Directors bring a wide range of experience to the Committee as outlined in the biographical details on page 19.

Under its terms of reference, the Audit Committee monitors the integrity of the Group's financial statements and any formal announcement relating to the Group's performance. The committee is responsible for monitoring the effectiveness of the external audit process and making recommendations to the Board in relation to the appointment, reappointment and remuneration of the external auditor. It is responsible for ensuring that an appropriate relationship between the Group and the external auditors is maintained, including reviewing non-audit services and fees. It also conducts twice yearly reviews of the Group's systems of internal control and the processes for monitoring and evaluating the risks facing the Group. The committee reviews the effectiveness of the internal audit function and approves the appointment and removal of the Head of the Internal Audit function.

Only members of the committee have a right to attend committee meetings. However other individuals such as the Executive Chairman, Finance Director and other Directors are invited to meet with the Audit Committee as appropriate. The committee also meets with both the external and internal auditors. The committee's terms of reference are available from the Company Secretary and are displayed on the Group's website www.graftonplc.com.

In 2004 the Audit Committee discharged its responsibilities by:

- Reviewing the Group's draft Financial Statements and draft Interim Result Statement prior to Board approval and reviewing the external Auditors detailed reports thereon;
- Reviewing the Group's development and trading updates prior to release;
- Reviewing the Internal Audit work program and all reports prepared by Group Internal Audit during the year including a review of the effectiveness of internal control;
- Reviewing the appropriateness of the Group's accounting policies;
- Reviewing the External Auditors plan for the audit of the Group. This included an assessment of the scope of the Audit work and confirmation of auditor independence;
- Reviewing Performance Improvement Observation Reports on internal controls in the Group's businesses prepared by the Auditors as part of the Group's external audit process;
- Reviewing risks associated with the business;
- Reviewing impact for the Group of compliance with International Financial Reporting Standards.

The committee also monitored implementation of the Group's Whistleblowing procedures, ensuring that appropriate arrangements were being put in place for employees to be able to raise matters of possible impropriety in confidence, with suitable follow up action.

The Audit Committee monitors regularly the non-audit services provided to the Group by the External Auditors in order to check that this does not impair their independence and objectivity.

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Remuneration Committee

The committee comprises Ms. Gillian Bowler, who chairs the committee, Mr. Anthony Collins and Mr. Richard Jewson all of whom are determined by the Board to be independent. The committee met 6 times during the year and the Directors' attendance at each meeting is shown in the table on page 27. The committee is responsible for making recommendations on remuneration to the Board. The committee reviewed its terms of reference and submitted revised terms of reference to the Board for its approval. Copies of the revised terms of reference are available from the Company Secretary or on the Company's website at www.graftonplc.com. The Chairman of the Remuneration Committee is available at the Annual General Meeting to respond to any shareholder questions concerning the committee's activities.

The committee's principal responsibilities are:

- Setting, reviewing and recommending to the Board for approval the Group's overall remuneration policy and strategy;
- Setting, reviewing and approving individual remuneration packages for executive Directors, the Executive Chairman and Company Secretary including terms and conditions of employment and any changes to their packages;
- Reviewing the salary structure and terms, conditions and benefits of employment of other members of the executive management as it is designated to consider;
- Approving the rules of any Group share, share option or cash based incentive scheme and approving the grant, award, allocation or issue of shares, share options or payments under such schemes.

Nomination Committee

During the year the Nomination Committee comprised Mr. Anthony Collins, who chairs the committee, Mr. Michael Chadwick, Ms. Gillian Bowler, and Mr. Richard Jewson. The Nomination Committee meets at least once a year, and additionally if required, to consider the Board's membership, to identify any additional skills or experience which might benefit the Board's performance, to interview candidates and recommend appointments to or, where necessary, removals from the Board. The Committee also reviews the performance of any Director seeking re-election at the forthcoming Annual General Meeting.

During the year the Board initiated the search for two Independent non-executive Directors. The Board began the process by identifying the core competencies required of the candidates to carry out that role. The Nomination Committee has employed a professional search firm to oversee the initial selection process and present the committee with candidates for interview.

The Nomination Committee's terms of reference were recently revised and the revised terms of reference can be found on the Group's website at www.graftonplc.com. Copies can be obtained from the Company Secretary.

Finance Committee

The Finance Committee comprises the Executive Chairman, the Finance Director and the Group Financial Controller. The Committee deals with capital expenditure and treasury activities within prescribed limits and other management issues.

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Internal Control

The Directors acknowledge that they have overall responsibility for the Group's system of internal control and for reviewing its effectiveness. The Directors recognise that such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material mis-statement or loss.

A process for identifying, evaluating and managing significant risks faced by the Group, in accordance with the Guidance for Directors on the 2003 Combined Code, has been in place throughout the accounting period and up to the date the financial statements were approved.

Group management are responsible for implementing strategy and for the continued development of the Group's businesses within parameters set down by the Board. Similarly, day to day management of the Group's businesses is devolved to operational management within clearly defined authority limits and subject to very tight reporting of financial performance. Group and operating company management are responsible for internal control including the identification and evaluation of significant risks and for the implementation of appropriate internal controls to manage risk. Group management report to the Board on key risks and internal control issues including the way in which these are managed.

The key features of the Group's system of internal control include:

- A clear focus on implementing the Group's strategy.
- Defined structures and authority limits for the operational and financial management of the Group and its businesses.
- A comprehensive system of reporting on trading, operational issues and financial performance incorporating results and cash flows, working capital management, return on capital employed and other relevant measures of performance.
- Board approval of capital expenditure and acquisition proposals.

The internal audit function focuses on areas of greatest risk to the Group, monitors compliance and considers the effectiveness of internal control throughout the Group. The audit committee receives reports and meets with internal and external auditors in order to satisfy itself on the adequacy of the Group's internal control system. The Chairman of the audit committee reports to the Board on significant matters considered by the committee.

The Directors confirm that they have reviewed the effectiveness of internal control. In particular, they have considered the significant risks affecting the business and the way in which these risks are managed, controlled and monitored.

Going Concern

The Directors, having made enquiries, believe that the Group has adequate resources to continue in operational existence for the foreseeable future and, on this basis, they continue to adopt the going concern basis in preparing the financial statements.

Compliance Statement

The company applied the principles set out in section 1 of the 2003 Combined Code for the period under review and has complied with the provisions of the 2003 Combined Code except that the roles of Chairman and Chief Executive are held by the same person and the number of independent non-executive Directors is less than half of the Board. The Board is in the process of appointing two additional non-executive Directors. During the year the Senior Independent Director has not attended meetings with major shareholders but has been available to meet shareholders. No meetings were requested by shareholders with the Senior Independent Director.