

Sussex Place  
Regent's Park  
London NW1 4SA

Telephone  
(+44) (0)71 262 5050  
Facsimile  
(+44) (0)71 724 7875  
Telex 27461

Sir Adrian Cadbury,  
Chairman,  
Committee on the Financial Aspects of Corporate Governance,  
PO Box 433,  
Moorgate Place,  
London EC2P 2BJ

20th November 1991

Dear Adrian,

Many thanks for your invitation to respond to the note on the "Role and responsibilities of auditors". I am sorry that pressure of work meant that I was not able to do so earlier.

First I should say that I am in agreement with the spirit of the paper, much of the detail and its conclusions. As a set of benchmarks for the Committee, the paper sets out the basis of the agenda very well for this part of our brief. I assume that some of the statements are intended to stimulate discussion rather than define answers and below I have listed a number of the areas where I believe the Committee still has to take a view.

**1. Page 1, para 4 ("The basic....")**

Despite the first paragraph on page 1, many auditors would question the reference to the decline in standards. They would see the current controversy as a manifestation of the expectations gap based on unrealistic public perceptions (as you point out on page 3, para 3). We will need to establish our position on the expectations gap in relation to the evidence that standards have declined.

**2. Page 2, para 1 ("...is required...")**

It could be argued that there is indeed an "accepted logic" but not (that dread phrase) an underlying conceptual framework. The ASB has said that it is determined to provide one. We will have to take a view on how far the existence of such a conceptual framework will solve or mitigate some of the problems and how far rules within the framework can be made to stick. If the view is that they can, some of the other problems should disappear.

**3. Page 2, para 3 ("This is....")**

We have to make up our minds about whether we believe that analysts do see through the figures (in which case "smoothing" is of much less concern).

**4. Page 2, para 4 ("This still...")**

If we are to include this element, we need to set out a comprehensive set of reasons for such behaviour.

**5. Page 7, para 1 (...usually assumes...)**

The avoidance of surprises may be tackled internally while the decision on what can be reported to the world brings with it a different set of considerations. We will need to discuss how far interests of the various actors in the corporate governance play are common or diverge.

**6. Page 7, para 2 ("Finance directors...")**

This didn't get much mileage at the last meeting but I am still concerned at the effects of the more powerful pull on the finance directors in their role as employees compared to their role as professionals. The rock on which the auditors are to stand will also need some standing room for finance directors.

**7. Page 7, point 4 ("Putting the...") and page 8, point 6 ("Encouraging shareholders....")**

In the section on "Role for the Committee" these two items are less specific than the others. Everyone will agree in principle, but we need to establish what is required for them to carry conviction.

**8. Page 8, last para, lines 4-7 "...will require..." to "...so much")**

The accounting profession and boards may see themselves as benefitting from the present position in the short run and at the moment individual (as opposed to institutional) shareholders do not have the means to take any effective action. A recommendation to take action in either area is unlikely to command support from all parties and if any action is to be effective it will need to take account of how behaviour is to be changed.

# BILL MORRISON

Output,

Good practice where such does not exist.

Rees. to specific parties.

Incentive to act? Sanctions?

Monitoring?

Encouraging response unanimous procedure but kept.

Listing - but require must link with Eur. stds.

Auditors report "intra jurisdiction".

Fraud, illegal acts.

Going concern,

Internal control

environment/pollution law, not resp.

for what don't know about

Cost setup system, procedures.

Definition of "expect's gap" (avoid phrase).

Joint disciplinary scheme. Not confined to Institute.

Regulate procedures, do not judgement. wh. in progress stocks debts.

Finally, two points of detail:

a. Page 2, para 2, line 4. Perfect markets depend on adequate rather than perfect information (which could be argued to be an impossible ideal).

b. I am not clear about the distinction at the end of page 3, para 3 between "professionally objective" and "independent". It may be worth clarifying this.

Love,  
Andrew

Andrew

# ANDREW LIKIERMAN

- 1) Stgy. has to be addressed ∴ perception.
- 2) Enough people believe there are problems to be tackled.
- 3) Phillips Drews — Not only rogues, good hand car wash, but well-known. cos. accused of creative alg.
- 4) Doesn't matter as mkt. more perceptive than a/c's.

Polly Peck, disclosure must be better.

Complaints higher now than in 1981.

But so much has changed

Expect's. higher rather than stds. lower.

Concerns about a/c's. not due to recession — brands merger.

All parties to debate saying stgy. similar.

All agree A&B. has to be more effective.

Weight of opinion from many different sources.

Need package

Take Issues away from other bodies

Encourage other bodies.

Stand behind partic. recs.

FRC. A&B. APB.

Policy deliberations, value added.

St/ldr / Bd. links fragmented

Wider perspective  
fin. reptg. in overall  
context of corp. gov.