

RECORD OF MEETING WITH MR CHRIS SWINSON, PARTNER OF BDO BINDER  
HAMLYN, ON 1 JULY 1991

Present: Chris Swinson  
Sir Adrian Cadbury  
Nigel Peace

1 Mr Swinson said that the ICAEW's Financial Reporting and Auditing Group (FRAG) was studying the questions of internal control, and forward-looking information in accounts, and he hoped that it would be able to express an early view. In both cases he thought that the Group would recommend that directors should have an obligation to make a statement in their report, and that auditors should be required to report on the reliability of the statement. So far as forward-looking information was concerned, his view was that the directors should go as far as confirming that the company had adequate resources to undertake its plans for the coming year, but not further. This would avoid the dangers associated with publishing forecasts, and would preserve the directors' responsibility for the accounts. It would also give the profession some answer to the demands of those like Austin Mitchell MP who wanted auditors to report much more widely on matters such as the risk of impending bankruptcy or insolvency. The profession was strongly opposed to this - auditors did not want to be required to take a view in areas where one man's prudent judgement was another man's recklessness.

2 Mr Swinson continued that if his view was accepted, auditors would need to look at the company's plans. The profession already had the necessary expertise arising for example from the work it did in reporting on profit forecasts in prospectuses prepared under Stock Exchange rules.

3 Mr Swinson said that FRAG was considering the Caparo judgement and would make a preliminary report in the early autumn. He was no great merit from the profession's position in mounting a campaign to get the law changed. Nor was he impressed by Mr Leek's proposal that a panel should be set up to resolve allegations of auditors' negligence outside the courts.

4 Mr Swinson said that other areas under consideration by FRAG included the appointment and remuneration of auditors, and their

resignation. One topic worth revisiting was the rules on public statements by auditors when they resigned. Under the Companies Act (S392A) resigning auditors had a right to require the directors to circulate to the shareholders a written statement of the circumstances connected with the resignation. However subsection 7 allowed directors not to circulate a statement if they could satisfy a court that the right was being 'abused to secure needless publicity for defamatory matter'. Using this subsection companies could hold up circulation of a resignation letter for quite a long time, and indeed it was questionable under current law whether auditors could actually make a meaningful resignation statement at all.

5 Mr Swinson continued that FRAG was not proposing to address questions of company structures and two-tier boards. There were problems: the more dominant the Chief Executive, the more pressure there was on the auditor to regard the board as the client, not the shareholders. This was unattractive in the long run, but there were no obvious solutions. He commented that the kernel of the problem was that executives were increasingly usurping the role of shareholders. In the 19th century, boards would comprise shareholders' representatives, not paid officers, and they would have an observer's rather than an executive role. In that sort of structure, many of the difficulties now being encountered did not arise.

6 Asked whether the Group had considered the suggestion that there should be a requirement to change the auditors after a fixed period, Mr Swinson said that it had been looked at informally. He believed that the evidence did not support the proposal. The Italians had enforced a periodic rotation but were now seeing difficulties, whilst evidence in the US was that audit failures were grouped around changes in the auditors. Also it had realistically to be expected that a process of competitive tender would ratchet up price competition which would not help the quality of the audit product.

7 Discussing the position in Europe, Mr Swinson said that in many areas a European view had not been reached and it was important that the UK should sort out its own mind so that it could then influence European developments accordingly. In one important area however European practice was established, and different from that in the UK. In many member states, unlike in

the UK, shareholders were required by law to approve the accounts. This meant that on the continent, the directors' responsibility for the accounts was discharged once the shareholders had approved them, but that in the UK the directors remained responsible until such time as they were freed by the statute of limitations. This had an impact on the role which the shareholders expected of the auditor.

8 Mr Swinson said that auditors had a right to attend AGMs and would often do so as a matter of good client relations, but not always. If an auditor was asked a question about the accounts at an AGM he would probably not go further than his published report - he would need authority to say more.

9 Mr Peace said that auditors had recently come in for much criticism and there was a danger that the Committee would be seen as in the hands of the profession if it did not produce a balanced package of recommendations. He asked what measures might be directed against auditors to balance any that were directed against directors and shareholders. Mr Swinson said that auditors could only operate properly when obligations had first been placed on directors. He would seek to make the relationship between the two sides much more constructive. Audit Committees staffed by genuinely independent-minded non-executive directors would be a very helpful step. At present when auditors did make informal criticisms of creative accounting - both as bad reporting and as bad business sense, too often the criticisms were ignored because the executive directors were desperate by any means to show a continuing trend. Relations needed to be much more constructive than this.

10 Mr Swinson continued that an option, albeit one that was deeply unattractive to auditors and the commercial world, would be to establish a Commission with powers to require a report from, and enter into a dialogue with, auditors in cases where dubious accounting practices were suspected. This would go much further than the Financial Reporting Review Panel which only had powers to deal with the revision of defective accounts and statements where there was evidence from the published statements of non-compliance with the Companies Acts. There was a precedent in the banking sector where regulatory responsibilities of the Bank of England could be a model to explore.

11 On the undercutting of audit fees, Mr Swinson said that his private view was that 'lowballing' would be eradicated only if firms depended solely on their audit income, and that there was therefore much to be said for ring-fencing the audit side of the business. However this view was open to the criticism that it would happen to suit the commercial circumstances of Mr Swinson's own firm.

A handwritten signature in black ink, appearing to be 'NDP', located below the main text.

NDP

4th July 1991