CAD-02255

SUMMARY OF RESPONSES BY COMPANIES

This note contains a full summary of the 70 responses received from companies (excluding banks) and business organisations up to 12 August 1992. The responses break down as follows:

Submissions by representative bodies: 3

Letters by company heads or by another director or the company secretary on behalf of the company: 47

Letters by top businessmen in a personal capacity: 9

Letters by finance directors in a personal capacity, and by regional/sectoral groups of finance directors: 11

A full list is at annex A. The CBI and IOD submissions are attached at Annexes C and D.

General reaction to the Report

The CBI, the Stock Exchange Listed Companies Advisory Committee, and the great majority of individual respondents who express a general view begin their letters with words to the effect that they are generally supportive of the initiative and the report, before going on to make detailed criticisms on individual aspects of the recommendations. In this category come Stanley Kalms (Dixons); Sir Paul Girolami (Glaxo); J N C James (Grosvenor Estate Holdings, a large private company); Gary Allen (IMI); Geoffrey Mulcahy (Kingfisher); Sir Richard Greenbury (Marks and Spencer); Sir George Russell (Marley); Sir Colin Corness (Redland); Lord Tombs (Rolls Royce); David Sainsbury (Sainsbury's); Sir Nigel Mobbs (Slough Estates); P A Davis (Sturge Holdings); Sir Richard Lloyd (Vickers); Lord Weir (Weir Group); Sir Patrick Sheehy of BAT (although very critical of 'major flaws' in the report); BP; Cadbury Schweppes; English China Clays; GEC (although their detailed comment is rather critical); GKN; Grand Metropolitan; Portsmouth and Sunderland Newspapers; and Unilever. Also generally supportive are the finance directors of Heath Group, Ladbroke, the Midlands Industry Group of Finance Directors, and the Thames Valley Commercial Group.

In the 'very supportive' category can be placed Michael Jackaman (Allied-Lyons); Neville Bain (Coats Viyella); Geoffrey Wilson (Delta); Geoffrey Maitland Smith (Sears); Sir David Plastow; Donald Main (Finance Director of Forte); National Grid; PowerGen; and South Western Electricity.

Those not expressing general support and whose letters are not supportive in tone are V W Benjamin (Deputy Chairman of Tesco and Lex Service); A C Bryant (Bryant Group); Sir Owen Green ('the need for a Code is doubtful'); Sir Ronald Grierson; and Sir Alick Rankin (Scottish & Newcastle).

Two small companies argue that the report is only appropriate to larger companies - Hardys and Hansons, and Eurotherm.

Other respondents comment on particular aspects of the report but do not place their comments in a context of general support or otherwise.

The main criticism of the report by companies is that it will divide the board (see below). Other criticisms of its overall thrust are as follows:

> Sir Colin Corness (Redland): 'It seems to reflect, somewhat unfairly, a view that public companies have a tendency towards wrongdoing whereas auditors need to be protected.'
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> GrandMet: 'It may over-formalise board processes and reports to shareholders. The report places too much emphasis on the role of external auditors and it is questionable whether some of the additional requirements for auditors (eg on interim reports, and other illegal acts) will add value, as opposed to cost.' Sir Nigel Mobbs (Slough Estates) makes the same point, giving as examples the requirements for auditors on interim reports and going concern.
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> P A Davis (Sturge Holdings): 'The general tone of the draft report gives the impression that many of the recent well publicised problems in British companies would have been avoided by the greater use of NEDs. It is wrong to give the impression that the appointment of NEDs is a panacea for every corporate ill and we believe that the draft report verges on this.' J J L G Sheffield (Norcross) makes a very similar point.

Sir Alick Rankin (Scottish & Newcastle): 'The Code and recommendations are, to an extent, an over-reaction to recent and spectacular corporate disasters brought about, evidently, by fraud and other illegal acts. Manifestly, voluntary codes cannot work if criminality is the reality of the problem.'

Geoffrey Mulcahy (Kingfisher): 'The general tone is somewhat negative on concentrating on the need for financial control. If British companies are to grow and prosper they need positive leadership. The implicit assumption seems to be that executive management cannot be trusted to work in the interests of the company and its shareholders and need a body of NEDs to act as a watch-dog. Casting the NEDs in this role serves to limit the effectiveness of the positive aspects which they can add to company policy.

'We would like to stress the need for a positive appreciation of innovation and growth and the encouragement of risk taking. The control element needs to be kept very much in perspective. Otherwise the report will add to other pressures which encourage companies to become more and more risk-averse, to the detriment of future shareholder wealth.' Sir Nigel Mobbs (Slough Estates) and V W Benjamin make the same point.

IOD: the general tenor of the report does not express with sufficient clarity our fundamental belief that corporate governance is a matter for directors. Also, by focusing on the accountability aspect of the directors' role it produces a distorted picture by ignoring the more positive aspects of corporate governance. The whole tenor is of directors requiring assistance in how to run companies. This presumption should be reversed. The responsibility for running companies is that of the board.

Setting for the Report (section 1)

The sentence in 1.1 that boards 'must have freedom to drive their companies forward' has attracted comment about the typical behavioural patterns of British compared to American boards. Sir Ronald Grierson argues that American boards do not 'drive the business forward', and that UK boards should not, but should play an essentially supervisory role. Sir Richard Lloyd (Vickers) comments that 'most UK Boards ... are probably more intimately involved in the knowledge, understanding and direction of the business than is the case with counterparts across the Atlantic. The reasons lie firstly in the UK practice of treating the board as more genuinely unitary in its nature, rather than more nearly supervisory, and secondly in the much lower UK proportion of NED component.'

Code might have prevented recent examples of unexpected company failure

V W Benjamin challenges the assertion in 1.7 and states that the Code certainly would not prevent fraudsters finding ways to defraud.

Statutory Intervention (1.8)

The CBI state that the report is right to reject the further major intrusion of law into corporate governance. This view is echoed by GrandMet. Lord Watkinson however would like to see legal sanctions to support the Code. Sir Patrick Sheehy (BAT) argues that if company law and practice and legal liabilities are inadequate, the Committee should face the possibility of legal reform - all concerned are entitled to the benefit of the certainty of a contemporary legal framework. Sir Nigel Mobbs (as Chairman of the Advisory Board on Deregulation at the DTI) is concerned 'that the measures impose additional regulation on business albeit of a non-statutory kind; and do not in concept necessarily match the essential criteria normally required of good regulation.'

Corporate Governance (2.5)

A full statement of the IOD's posture in relation to corporate governance as a whole is set out on pages 1 to 5 of their submission at Annex C. The IOD state that 'the setting of a company's strategic direction, ensuring its implementation, supervising management, and providing information regarding the affairs of the company to those entitled to receive it are exclusively a matter for directors. Whilst shareholders and auditors have their role in relation to the running of a company, questions of corporate governance are determined in the boardroom and nowhere else.' The IOD do not accept the Committee's ownership concept of the role of institutional shareholders.

<u>The Code of Best Practice (section 3)</u>

The CBI stress that the Code must remain flexible and offer guidance rather than rigid prescription. Other comments:

<u>Stock Exchange Listed Companies Advisory Committee</u>: 'The Code reflects the best practice of many major UK companies. Most of the companies represented on this committee would be able to meet the Code, without changes to their existing procedures.'

<u>Sir Richard Greenbury (Marks and Spencer)</u>: 'we do not believe that there is one board structure or format which is appropriate for every type of company, industry, or business culture.'

<u>Unilever</u>: the code should contain general statements and it should then be left to individual companies to implement them as suits their individual circumstances.

<u>Kingfisher</u>: the report and code must make it crystal clear that there are different ways of achieving the objectives. Otherwise, companies not conforming identically will be considered 'politically incorrect' by influential commentators.

<u>Scottish and Newcastle (Sir Alick Rankin)</u>: 'We accept that a voluntary code can do a lot to identify desirable best practice and, thus, to introduce added discipline and improved standards. Such a code will do little to improve company achievement if it introduces a new level of bureaucratic interference and unrealistic compliance demands.... A balanced, moderate code could be an acceptable start against which, once agreed, self compliance can be publicly reported and questioned, in consequence, by shareholders.'

<u>Sir George Russell (Marley)</u>: 'The report should recognise that differing company situations demand different board structures and what is right for one company is not necessarily right for others. Similarly a company's needs change over time .... The most effective means of providing the necessary checks and balances in the overall structure of corporate governance is the establishment of properly constituted

committees of independent, competent directors acting conscientiously in the interests of the shareholders in monitoring the operations of the board.'

The CBI state that the Code should contain no cross-references and should be able to stand on its own. The same point is made in many company responses.

The IOD support the concept of the Code and believe it will enhance public confidence in the audit process.

Statements of compliance (3.7 - 3.10)

The Stock Exchange Listed Companies Advisory Committee comments that it believes that the proposed statement of compliance, produced as a Continuing Obligation of Listing, 'should be a sufficiently flexible mechanism for enforcement especially if the Exchange is able to require public disclosure of the extent of non-compliance. It would be inappropriate for compliance with the Code to be a mandatory condition of listing; shareholders must be allowed to make up their own minds on whether companies are justified in departing from the Code. It will be important that the Exchange is aware of the particular constraints on small companies and does not publicly criticise instances of non-compliance by those for whom certain aspects of the Code are inappropriate.

The IOD welcome the concept of a statement of compliance. The CBI also support the idea of compliance statements, but argue against a Stock Exchange listing obligation, on the grounds that it will make the Code less capable of flexible change and interpretation, and that the ultimate sanction of delisting is inappropriate. They state 'Where investors wish to intervene with a board, they can invoke the Code and the company's compliance with it according to the particular circumstances. A listing obligation is not necessary for this purpose. Indeed such a requirement could lead to over-elaboration of the Code and proliferating bureaucracy.......The Code will assume the status of a quasi-legal document, and boards and their professional advisers will seek guidance on the precise form and nature of the statement they are expected to make.'

A selection of comments by individual companies is as follows:

Geoffrey Mulcahy (Kingfisher): 'Although we favour a public statement of compliance .... we do not agree that certain provisions of the Code should be included as a listing requirement. Companies should be able to interpret the Code flexibly and in a way which suits their own circumstances without it being regarded as simply another addition to company regulation to be observed to the letter.'

Sir Richard Lloyd (Vickers): 'We agree that a sanction will be needed to compel compliance with the Code but, like the CBI, we feel that a threat of withdrawal of Stock Exchange quotation is perhaps too draconian, and too far removed from what I see as institutional shareholders' responsibilities to intervene where necessary in the corporate governance of companies in which they invest. I would prefer it if the sanction could instead take the form of organised and harnessed pressure from the companies' larger institutional shareholders as an exercise of their ownership role, perhaps with guidelines to be devised by the ISC.'

Sir Richard Greenbury (Marks and Spencer): 'We do not believe that compliance should effectively be made mandatory by making it a condition of listing.'

Unilever: 'It is not reasonable that the large number of companies for whom it is inappropriate to adopt certain of the Code's proposals be put in the position of having to defend themselves.'

Rolls Royce oppose compliance statements on the grounds that they will tend to enforce lowest common denominator standards and make alterations to standards hard to achieve; and because what makes sense in some industries and size of business may not in others.

Sir Nigel Mobbs (Slough Estates): 'We believe it is important to ensure that there is scope for reasonable flexibility in applying these guidelines in order to:

a) avoid companies being unreasonably criticized
b) enable companies to arrange their methods of governance to suit their own strengths and circumstances

c) provide for improvement of procedures by responsible experiment.'

Sir Alick Rankin (Scottish and Newcastle): 'It is not acceptable for a voluntary code to be linked to SE listing obligations. It should remain essentially voluntary and "best practice".'

BAT: 'It is essential that both the Code and the guidance from the APB be available before any decision be made as to whether the Code can be made an ongoing listing requirement. If, despite our deep reservations, it does become a listing requirement, it needs to be reduced to a number of key and easily verifiable requirements.'

David Sainsbury: 'The technique of using the Yellow Book requirement to enforce the Code is an excellent way of ensuring speedy action whilst retaining the flexibility to develop the Code.'

Cadbury Schweppes: 'There does not appear to be any real sanction for non-compliance, and this is an issue which, in our view, the Committee should give more consideration to.' The Nationalised Industries Finance Panel, Rowena Mills (member of the FRC), and Donald Main (Finance Director of Forte) make the same point. Donald Main observes the respect achieved by the Financial Reporting Review Panel in a short space of time, in part by the publicity given to its findings.

The CBI would like the final report to carry a sample compliance statement by way of illustration and guidance.

Start Date (3.7)

The CBI argue that the proposed start date (reports for year-ends on or after 31 December 1992) will give companies little time to respond to the recommendations, especially if they change from the current draft, and that a later date of, say, 31 December 1993 would be more appropriate. The CBI suggest the Committee can still recommend that companies comply with the Code as soon as possible and encourage disclosure of their level of compliance in the meantime.

Some individual responses by companies also express concern about the start date. GKN suggest 30 June 1993.

Statements on corporate governance (3.8)

Geoffrey Wilson (Delta) has reservations about the value of such general statements and does not believe that reports should become over-cluttered with too many statements of how the company discharges its responsibilities to all and sundry.

Endorsement by the auditors (3.10)

The CBI do not consider it appropriate for the compliance statement to be reviewed by the auditors, on the grounds that they cannot comment with authority on judgemental matters especially as they do not regularly attend board meetings and cannot assess how the board conducts itself. Others commenting that the auditors are not the appropriate agency to endorse compliance are Sir Richard Greenbury (Marks and Spencer); Gary Allen (IMI) and Sir George Russell, who both comment (forcefully in the latter case) that auditors themselves should subscribe to the Code for their own organisations; BP; Unilever; Sir Alick Rankin (Scottish and Newcastle); and Geoffrey Mulcahy (Kingfisher). Sir Paul Girolami (Glaxo) notes that the auditors would have to pass some kind of judgement on compliance statements where the board was explaining non-compliance. He questions whether the Committee is clear about the extent to which it is asking auditors to assume responsibilities beyond their usual professional limits. The IOD also express concern.

Cadbury Schweppes say that the auditors' endorsement should be limited to areas that can be clearly identified and quantified.

Europe

The only reference to European developments is in 3.12. BP Europe would like to see some reference to the European context. GEC comment that they would have expected to see a discussion of the position in other countries. Unilever argue that UK practice must remain sufficiently flexible to take account of the EC directives and to allow companies to adopt a variant of the two-tier system if they feel it appropriate, e.g if they have substantial interests in countries where a two-tier structure is mandatory.

<u>**Review of the Code (3.13)**</u>

The IOD and Stock Exchange Listed Companies Advisory Committee support the proposed review after two years. The CBI also support it, but comment that 'ownership of the Code needs to be clearly established', and that firm arrangements for a review body should be proposed in the final report. Sir Patrick Sheehy makes a similar point, noting that experience with the City Code on Takeovers and Mergers suggests that someone will need to be responsible for updating rules, notes, explanations etc.

<u>**Small Companies (3.16)**</u>

The CBI say it should be recognised that not all of the practices advocated will be relevant to the smaller company. The Stock Exchange Listed Companies Advisory Committee urge the report to lay greater stress on the need for flexible application of the Code to small companies, and comment in particular that it will be difficult for small companies to find the right calibre of NED, especially if those having a business connection with the company are to be excluded. V W Benjamin notes that it will be difficult to obtain an adequate supply of NEDs for smaller businesses as they will not be rewarded with prestige.

Sir Patrick Sheehy states that the burden on small companies is likely to be considerable and that there has been insufficient cost/benefit analysis. Sir Nigel Mobbs (as Chairman of the DTI's Advisory Board on Deregulation) asks whether a compliance cost assessment should be undertaken. Others noting the cost impact of the recommendations include BAT and IMI. The IOD also express concern, particularly in respect of increased audit costs.

Smaller listed companies have written to protest about the application of the report to them as follows:

> <u>Hardys & Hansons plc</u>: the report will add to the costs of small companies by requiring the size of their boards to be increased. The Code should be directed at larger listed companies only.
>
> <u>Eurotherm</u>: in order to make decision-making less cumbersome, Eurotherm decided to reduce board size and refer policy implementation to a management board completely separate from the legal board of directors. 'Implementation of the recommendation to form an audit committee of NEDs

would have two implications. Firstly, as we have only two NEDs in a total of five directors, it would probably be necessary to appoint at least two more directors, one being non-executive. Secondly, and most importantly, by giving a special 'watchdog' role to a non-executive audit committee, there would be a tangible split in what we consider desirably a small, balanced team. I cannot overemphasise the value to the building of a business of the bringing together of a team with complimentary talents. Harmonious collaboration of the board has been a major factor in taking Eurotherm from a small start to its present significance and I do not consider it appropriate to change the fundamental format at this stage of the company's development.... I would ask that there not be blanket rules which ... may profoundly damage the culture of businesses which represent the country's future.'

J C Kay (Finance Director, Gaskell plc): 'It is clearly inequitable that the smaller plc should suffer market stigma year by year simply because it has to provide a list of its non-compliance with a Code that is inappropriate to its circumstances. Clearly there should be a gradual evolution of compliance according to size.'

Candover Investments plc: 'In most respects we comply with the recommendations. We hope we will not be forced to incur a lot of extra work and expense which will not materially improve the understanding of our company but which will produce juicy fees for the professionals.'

Rowena Mills (member of the FRC) believes all companies, regardless of size or listing, should try and comply with the recommendations although she recognises that cost will inhibit them to some extent.

The Board

The principle criticism of the report by companies is that its effect will be to divide the board or dilute its collective responsibility. A sample of comments to this effect is as follows:

CBI: the Code as drafted undermines the unitary nature of the board by reserving certain functions of the board for NEDs and casting them primarily in a monitoring or policing role. The proper approach should be to emphasise that the distribution of responsibilities is a matter for each board.

Stock Exchange Listed Companies Advisory Committee: 'We recognise the balance to be struck between allowing a company to develop dynamically and ensuring proper accountability. This balance can best be secured by a board in which NEDs and executive directors work in close collaboration and with complete acceptance of their collective responsibility for the affairs of the company. Care is needed to avoid dilution of the responsibility of the board as a whole and of each individual director by its transfers to committees of the board, especially those composed of NEDs, as there will then be less opportunity for executive directors to fulfil their proper function in the governance of the company.'

Sir Owen Green: 'The report begins its section on corporate governance by defining it as "the system by which companies are run". It is not: running the company is the function of the executive. If taken literally, the report's recommendations would produce a hydra-headed organisation, alien to the aims of drive and efficiency. For example, 4.3 urges that "if the chairman is an executive director, a senior non-executive director should be appointed to take the lead", presumably against the chairman and his executive colleagues. This unworthy proposal could easily be avoided by requiring instead that the chairman should not also be the chief executive. In any company of size, the roles are distinct and sometimes incompatible.

'This is not the only example of the report's belief in committee paramountcy. Elsewhere, for example, it suggests that the chairman of the company may no longer be responsible for answering questions at the AGM about audit matters... Yet another spokesman may need to answer to the AGM on remuneration.

'A more divisive aspect of 4.3 is the way it strikes at the heart of the unitary board. It begins by restating the legal position that all directors are equally responsible for the board's decisions. But the Committee immediately reveals its view of the real purpose of NEDs. They are there to monitor the performance of the board (including themselves?) and that of the chief executive. As mentioned earlier, the paragraph recommends "the appointment of a senior NED to take the lead, in order to maintain the balance between executive and non-executive influence". If the members of the Committee believe in a unitary board, as I do, this is nonsense. If they seek this kind of segregation, they should have the courage of their convictions and advocate a two-tier board structure.'

Sir Patrick Sheehy (BAT Industries): 'The report emphasises distinctions between executive and non-executive directors, although there is no such distinction in company law. Furthermore the distinction could lead to a polarisation within the board... This risks appearing to encourage a two tier board system, and detracts from the fundamental concept of collective board responsibility. Any change in this approach should be statutory. Assuming the Committee supports the UK's unitary system, it should explicitly state this, and the reasons why it prefers this system.'

GEC: 'The whole thrust of the report is to retain the unitary board but to attempt to engraft a two-tier structure on to it. This is not a workable arrangement.'

Sir Paul Girolami (Glaxo): The report goes beyond its declared terms of reference 'and goes too far in formalising the separate role of the NEDs. In the longer term several of the report's recommendations, and much of its supporting argumentation, could create a tendency towards factionalism within the boardroom. This might be necessary if the role of the NEDs were solely to prevent lapses of corporate governance of the type infamous in recent years. It would then be reasonable to conceive the NEDs as the watchdogs or guardians of the shareholders', or even the public, interest, and to provide them with the necessary framework to exercise that role. However we do not see this as the only - or even primary - role of the NEDs. They bring to the boardroom independence and outside experience which cannot be provided by the executive directors, and those qualities are (or ought to be) deployed to enhance general decision-making of the board on all aspects of corporate affairs with which it has to deal. The constructive harnessing of this spectrum of experience requires the creation of a team ethos.

'For this reason, it is difficult to support the Committee's concept of a 'leader' of the non-executives, whether formally appointed or not...

'The Committee itself admits that the cadre of non-executive directors is not there simply to restrict or police the actions of the executive directors. Yet the concentration upon this aspect of the role of the NEDs which permeates the report could be damaging to the creative balance between NEDs and executives which most companies seek to achieve. If the Committee was right to move outside its financial remit, it should have reviewed the role of the NEDs in its fullest context, and not merely partially, in order to establish a balanced view.'

Lord Tombs (Rolls Royce): 'We see no reason to distinguish between the responsibilities of executive and non-executive directors in the capacity of director, save in relation to remuneration... In particular we would like to see more focus on how best to integrate and thus enable NEDs to contribute effectively to a company's activities; provide access for NEDs to both information and management; ... and ensure that directors are mindful of and discharge their legal responsibilities, having access to independent legal advice where necessary through the Company Secretary... We see no reason why a NED should be inherently more objective or why, as individuals or as a group, their powers and responsibilities should be different.'

A C Bryant (Bryant Group): 'Our board do not accept the assumption that NEDS are the only members of the board who are able to look after corporate governance. To make this assumption is a slur on the executive directors and may lead to a quite unnecessary division of the board. We believe that both executive and non-executive directors have equal responsibility for corporate governance and this should be recognised accordingly. We have therefore appointed our whole board, both executive and non-executive directors, as the audit committee, with the proviso that the auditors may request a separate meeting with the chairman or NEDs if they so desire.'

Sir Richard Lloyd (Vickers): 'When previously Sir David Plastow combined the roles here of Chairman and Chief Executive, I was then, as Deputy Chairman, appointed "Convenor" of the NEDs. In the event that your Committee conclude that any designated person is required from among the NEDs, I would commend this word "Convenor" to you. It is more felicitous and less divisive than "leader". To have two leaders on any board can only accentuate the "we" and "they" rankings which, if too constantly emphasised in boardroom bahaviour, seriously weaken a board's effectiveness and stewardship in carrying out its main task. That task is to choose the company's strategy and to guide, direct and motivate colleagues in its successful execution.

The monitoring/financial reporting function, and checks and balances of power within a board need to fit into that greater framework of corporate governance. We hope that your final report could draw more attention to the larger framework so that the financial aspects of governance are seen more clearly in context.'

Comments in similar vein have been received from Stanley Kalms (Dixons), J N C James (Grosvenor Estate Holdings), Gary Allen (IMI), Sir Desmond Lorimer (Lamont Holdings), Sir Richard Greenbury (Marks and Spencer), Sir George Russell (Marley), J J L G Sheffield (Norcros), Sir Colin Corness (Redland), David Sainsbury (Sainsbury's), Sir Alick Rankin (Scottish and Newcastle), P A Davis (Sturge), J B H Jackson ('professional' non-executive chairman of several listed companies), Andrew Robb (Finance Director, Pilkington), J F O'Mahoney (Finance Director, Ladbroke), V W Benjamin, CM Stuart, R C Tomkinson, Barratt, BP, GrandMet, IBM, the IOD, and the Midlands Industry Group of Finance Directors. Criticism is directed specifically by these authors at one or more of the following features of the report:

- the suggestion that NEDs should appoint a leader (4.3 and 4.6);

- the statement in 4.3 that 'the NEDs are in the best position to monitor the performance of the board and that of the chief executive';

- the suggestion that only NEDs should have access to independent professional advice at the company's expense;

- the recommendation that the chairmen of the audit and remuneration committees should be responsible for answering questions at the AGM;

- (more generally) the failure to bring out positively the responsibilities of the executive directors.

General warnings against moving to a two-tier board structure come from Cadbury Schweppes, and GKN.

Alternative views are as follows:

Sir Lewis Robertson: 'I am convinced that one important element of any positive step change must be to stiffen the responsibility and to strengthen the authority of serious NEDs. The draft report moves things a certain way in this direction, but I am not persuaded that it goes far enough. One possibility would be that the external directors (including the chairman if he were not executive) should each be responsible for signing a small separate report to the shareholders, confirming their satisfaction that certain scheduled procedures and standards were being met.' Sir Lewis goes on to mention Supervisory Boards as a second possibility worth pursuing.

Neville Bain (Coats Viyella): 'There has been some debate about creating a split, according to executive or non-executive roles when all are legally directors. I do not share this view as the competent chairman can, with skill, ensure team working, openness, and effective functioning. There will always be some trade off with the need to provide checks and balances and the additional small burden on the chairman. To achieve the balance is a preferable solution to not exercising independence of non-executives or monitoring the executive management.'

The board must meet regularly, retain full and effective control over the company and monitor the executive management (Code 1.1)

The CBI oppose the words "monitor the executive management" as imparting a supervisory role inappropriate to a unitary board.

Sir Richard Lloyd (Vickers) comments that frequency of meeting and size of board are more relevant to effectiveness than the report shows. He commends Vickers' monthly meetings and small size (eight, as it happens half executive and half non-executive).

Equal responsibility of all directors (first line of 4.3)

Sir Richard Greenbury (Marks and Spencer): 'The Code should emphasise more strongly the existing legal duty that each director of a company owes to shareholders for all decisions, whatever particular responsibility he or she may have within a company.'

The Chairman (4.4 - 4.5)

Neville Bain (Coats Viyella): the chairman should be encouraged formally to appraise the role of the board annually and make the time to talk to each director about their perspective of the board's effectiveness.

Combined roles of chairman and chief executive (4.6 and Code 1.2)

The CBI support the wording of the Committee's recommendation, subject to the comment that 'We have no great liking for the term "leader" but support the concept that there should be a rallying point for directors with concerns about the operation of the board, if the chairman has an executive role.' This is a central position between the views of GrandMet, who like the recommendation as drafted, and those such as Sir Richard Greenbury (Marks and Spencer), who oppose the idea of an appointed leader of the NEDs but otherwise support the recommendation. The Stock Exchange Listed Companies Advisory Committee state "We acknowledge the need for an effective counter-balance to the individual at the head of a public company."

Unilever prefer to talk of sharing responsibilities rather than dividing them.

J B H Jackson ('professional' chairman of several listed companies) would not argue for never combining the two roles but would expect a stronger warning:

> 'The chief executive is accountable to the board for the way in which he discharges the responsibilities delegated to him. Although this is done formally at board meetings, it also takes place continuously and less formally between board meetings through his relationship with the chairman. The chairman is the guardian of the interests of the board between board meetings and has a duty to use his judgement on whether something the chief executive proposes or contemplates reflects policy already approved by the board or requires consideration by the board. If the two roles are combined into one, then for much of a company's life an individual is accountable to himself.'

Sir Alick Rankin (Scottish and Newcastle) would like the wording of 1.2 in the Code strengthened so that 'strong independent element' reads 'particularly strong independent element.'

The following argue that the Committee should come out firmly against combining the two roles: Sir Desmond Lorimer; Sir Owen Green; and Neville Bain (Coats Viyella).

David Sainsbury does not think that the Committee should argue against combination of the roles even in principle. He comments that job titles are to some extent a matter of semantics, and that individual companies should be left to settle things on the basis of their own requirements.

V W Benjamin comments that even more sinister than domination by one individual is the case where two people, the Chairman and Chief Executive, collaborate against the interests of the shareholders (eg Barlow Clowes).

Calibre and number of NEDs (4.8, Code 1.3, 2.1)

The CBI support what is said here; but comment that the report as a whole, by focussing on NEDs' monitoring role, understates the contribution they can make to the growth of a business.

C M Stuart, drawing on his experience as Chief Executive of Berisford International, comments that the main failing of the board was to avoid imprudent decisions and that NEDs should involve themselves in thoroughly understanding the major decision-taking activities of the board.

V W Benjamin, commenting on PRONED's 'Executive Summary into the Role of the Non-Executive Director', states:

> 'I think that any view that suggests that NEDs should not participate in the formulation of strategy is totally erroneous. NEDs are directors and equally responsible with the executives for all policy matters and equally answerable to all stakeholders. There are some robust comments on page 9 of the document about NEDs which show how badly management can use them.'

Sir Owen Green states that the use of the word "independent" in 2.1 of the Code is ambiguous and provocative. He commends instead "NEDs will each bring their own judgement..." Sir Alick Rankin (Scottish and Newcastle) says 'The word judgement requires some clarification as it does not convey the role of NEDs as members of a 'team'. He does not consider it appropriate for NEDs to be involved in appointments other than board appointments.

David Sainsbury notes that the report makes no reference to a specific number of NEDs and suggests that it should clarify whether the Committee agree with the PRO NED recommendation that a minimum of one third of directors should be non-executive. Neville Bain would also like a statement of best practice (eg minimum of three NEDs, or minimum of one third and never less than two).

Independence of NEDs (4.9, 4.10, and Code 2.2)

The CBI comment that some (not all) members take the view that issuing share options to NEDs is compatible with their positive role in developing the longer term strategy of the business. V W Benjamin (declaring a personal interest) regards share options and pensions as quite suitable for NEDs, and thinks this is beginning to be the current view in the US.

GEC does not understand why the Committee only recommends that the majority (not all) NEDs should be independent. GEC would ban reciprocal directorships between companies.

Sir David Plastow's view is that all NEDs should be independent, though he can see that in special situations such as cross shareholdings there may be a case for a majority rather than all. The status of NEDs who are nominated by an associated company with a substantial stake is also raised by Sir Lewis Robertson. His pragmatic approach is to regard them as non-executive directors for most purposes but to treat them as in some way "special" when matters under discussion relate in any way to the associated company.

D E Reid (Finance Director, Tesco) understands the desire for independence in NEDs but points to the benefit to be gained from NEDs who may also be company advisers, but provide a major constructive input to the company; and from those who over a long period of time (much greater than the recommended two terms of office) provide valuable continuity.

GKN would like to see a requirement for companies to disclose, in respect of each director, all non-executive directorships of quoted plcs to make it easier for shareholders to assess whether they have sufficient time to be effective directors of the company.

Sir Owen Green states that 2.2 of the Code is too restrictive as to business and financial connections. Sir Alick Rankin would place 'material' before 'business and financial connections' and would replace 'should' by 'may' in the last sentence.

Access to information for NEDs (4.11)

V W Benjamin comments that access to all the information available to the executives and a proper induction course is absolutely crucial for NEDs.

An agreed procedure for NEDs to take independent advice (4.12, Code 2.4)

Many submissions support the recommendation but comment that that the procedure should extend to every director on the board (CBI, Marley, Glaxo, Stock Exchange Listed Company Advisory Committee, Sir Owen Green, Courtaulds, GKN, GrandMet, Glaxo, and Scottish and Newcastle.)

The CBI would like the Committee to give guidance on what the appropriate procedures should be. Sir Owen Green says that there must be some safeguard against misuse. GrandMet say there needs to be an appropriate consultation procedure and attach their Board Resolution on the subject (Annex B). Rolls Royce state 'in our case, the company secretary will be the conduit of independent advice for quality control and confidentiality reasons (but only disclosing who had access to what advice with permission from the person who has sought the advice).' Glaxo say the right should be restricted to advice on the individual director's position vis-a-vis the company and Andrew Robb (Finance Director, Pilkington) to cases where there is a conflict of interest. Scottish and Newcastle say it should be after agreement with the board, which should not be unreasonably withheld. Sturge Holdings also believe that it should only be obtained with the agreement of the executive members of the board, following open discussion. V W Benjamin comments that 'the concept needs care and perhaps legislation but generally is correct. Perhaps payment by the company for advice to individual directors should only be available where either the Bank of England or the Stock Exchange acknowledges there is a genuine conflict.'

The recommendation is opposed by GEC ('This recommendation is likely to lead to disruption of business, public argument, and incurring substantial costs over which the company has no control.')

NEDs should be selected through a formal process and their nomination should be a matter for the board as a whole (4.13, Code 2.5); nomination committees (4.24)

A selection of comments is as follows:

CBI: the recommendation in the Code should apply to all directors, not just NEDs; and the Committee should make clear whether it is recommending nomination committees as part of the Code.

Sir Paul Girolami (Glaxo): the apparatus proposed is too formal. 'Its intention appears to be to introduce an objective "trawling" of the market of the kind which might precede the appointment of an outside senior executive. It will not prevent what it is intended to prevent in those companies where prevention is needed, and will merely constitute an irritating ritual in those companies where it is not.'

English China Clays oppose the formation of yet another committee. 2.5 of the Code should restrict itself to a statement of general principle rather than require a formal selection process (eg 'NEDs should be selected on merit and their nomination should be a matter for the board as a whole'). This would leave it to the individual board to decide on the level of formality required for the process of selection, in accordance with what suited the particular company.

The Stock Exchange Listed Companies Advisory Committee: 'The creation of a nomination committee is not necessary for many companies, including the smallest and those where external head hunters bring forward nominations to the full board. Flexibility of approach should be maintained.'

Lord Tombs (Rolls Royce): 'We see little point in setting up a special committee for what should be an infrequent exercise. The board should decide on who its members should be.'

Sir Alick Rankin (Scottish and Newcastle): '2.5 of the Code should be extended to both executive and non-executive directors.'

Geoffrey Mulcahy (Kingfisher): 'We do not believe a nomination committee is absolutely necessary for the occasional appointment of NEDs, but is as well served by an ad hoc process provided this gives a satisfactory degree of consultation and communication with existing directors over the appointment.

Sir Richard Greenbury (Marks and Spencer) disagrees that nomination committees should be composed of a majority of NEDs, since they are unlikely to have the necessary knowledge to make the decision. The chief executive should be in the lead.

Support for nomination committees comes from Sir Desmond Lorimer (who argues that they should not be chaired by the chairman). Two companies suggest that nomination committees might be combined with the remuneration committee.

Several respondents express scepticism about whether there are enough potential NEDs of the right quality available (CBI, BAT, C M Stuart, and J F O'Maloney (Finance Director of Ladbroke).

NEDs should be appointed for specified terms, and reappointment should not be automatic (4.14, Code 2.3)

The CBI comment that all directors should be subject to retirement and re-election by rotation at intervals of not longer than 3 years. The same point is made by J B H Jackson ('professional' chairman of several listed companies).

Shell comment that their NEDs retire by rotation and therefore as a practical matter have to be re-elected by the shareholders at intervals of about two/three years. They would like 4.14 to be expanded in the light of this practice.

Sir Alick Rankin suggests the appointment letter should indicate that normal practice is to make an appointment for 6 years, but that there may be cases where the company would wish to extend this period. V W Benjamin also favours 5 to 6 years as the appropriate term of initial appointment because the first 12 to 18 months are not very useful.

Directors' Training (4.15 - 4.16)

The CBI strongly support the establishment of training programmes for all directors. Donald Main (Finance Director, Forte) would like to see greater force given to the need for training, particularly for executive directors who have risen up through the company with little need to be concerned about many aspects of corporate governance. The Nationalised Industries Finance Panel criticise the failure to recommend a comprehensive approach to directors' training.

Rolls Royce say 'directors should be chosen for the qualities they bring to the board. Training should be optional.'

Boards should have a formal schedule of matters reserved to them for decision to ensure that the direction and control of the company is firmly in their hands (4.19 and 4.20, Code 1.4)

The CBI would prefer to turn this round so as to recommend that boards should define what they expressly delegate, rather than what they retain. Delegations should then be subject to appropriate systems of internal control.

Rolls Royce, BAT, and GEC reflect this line. GEC: 'All matters are for the full board except those that bave been expressly delegated to committees of the board. It is not unusual for listed companies to have a board committee to deal with material operating matters in the period between board meetings. We have a General Purposes Committee whose terms of reference require an NED to be present for it to be quorate.'

Barratt say it would be helpful for the Committee to indicate the content of the formal schedule of matters reserved to the board. Sir Lewis Robertson suggests that it should be emphasised that there are many other matters, outside the financial aspects scope of the report (eg senior appointments), which should also be scheduled for decision by the full board. V W Benjamin would include diversification, succession for board and senior management, and an annual review of strategy.

Sir Owen Green comments that the use of the word "direction" in the Code is ambiguous: 'if used in the operational sense it is not supported. If it relates to strategy it makes sense.'

Statement of directors' responsibilities (4.22, Code 4.5)

Agreed by the CBI, who comment that there should be a provision in the Code to cover the auditors' statement.

Neville Bain (Coats Viyella) comments that if a statement becomes too formalistic, and annually repetitive, it will lose real value. His preferred alternative is to require the audit committee to report to shareholders on the scope of its work, the extent that they have reviewed the accounts and that they are satisfied with their integrity and that all relevant information has, to the best of their knowledge and belief, been properly disclosed. (This would also subsume the statement on going concern.)

Sir Owen Green regards this as a fussy and superfluous proposal. Brixton Estate think it may lead to misunderstandings about the relative responsibilities of directors and auditors.

Codes of Ethics/Statements of Business Practice (4.23)

Brixton Estate would find further guidance on the type of information to be included in such documents helpful. Andrew Robb (Finance Director, Pilkington) opposes them as 'motherhood statements' adding nothing to quality.

Directors should report on the effectiveness of their system of internal financial control (4.26; Code 4.2)

The CBI support in principle but argue that the provision should not stand as part of the Code until the detailed guidance has been agreed. The IOD also support in principle while noting that application in practice will require very careful consideration.

Sir Colin Corness (Redland) suggests that 'internal financial control' should read 'financial control'.

Sir Owen Green believes this is 'another fussy and superfluous proposal'. Julian Sheffield (Norcros) doubts whether it will serve any useful purpose as it is difficult to imagine any company saying anything other than "we believe our internal financial controls are adequate". Sir Alick Rankin (Scottish and Newcastle) makes the same point. Brixton Estate think the adequacy of internal control should be left to the audit committee.

BP comment that the report takes it for granted that readers share a common understanding of what internal control is. 'In reality there are widely different perceptions of what it means. A definition would help and the Treadway's attempt might avoid the need to re-invent the wheel;

"Internal control is the process by which an entity's board of directors, managements and/or other personnel obtain reasonable assurance as to the achievement of specific objectives; it consists of inter-related components with integrity, ethical values and competence, and the control environment, serving as the foundation for the other components which are: establishing objectives, risk assessment, information systems, control procedures, communication, managing change and monitoring."

BP stress that internal control has wider application than the area of financial recording and reporting.

The Midlands Industry Group of Finance Directors oppose the recommendations on the grounds that internal control is a management issue, not an issue of corporate governance.

Audit Committees (4.27 - 4.31; Code 4.1, 4.7)

The CBI would support a recommendation to establish audit committees, but not the prescriptive language of the Code, on the grounds that some companies hold the view that there should not be any intermediary between the auditors and the whole board. The CBI do not agree that membership should be restricted to the NEDs.

The IOD support the Committee's recommendations, except in calling for all listed companies to establish audit committees immediately.

Other comments are as follows:

Stock Exchange Listed Companies Advisory Committee: 'Audit Committees, whilst they have a valuable part to play, should not detract from the responsibility of each and every board member for the accounts; auditors should expect to report to the full board, not just to a committee.

IMI: support the recommendation to establish audit committees; membership should not be restricted to NEDs but should comprise those whose personal skills and attributes make them most suitable to be appointed;

GEC: support the recommendations in 4.29 but do not agree that membership should be confined to NEDs - it should be sufficient to provide that a majority are NEDs. 'The functions of an audit committee are two-fold: first, particularly in a complex group with numerous operating subsidiaries, the committee is an extension of the board appointed to assist the board as a whole and each of the individual directors, both executive and non-executive, in discharging their duties to shareholders. Secondly, the audit committee should review and monitor the way in which the financial function is carried out, with particular regard to the internal control systems within the company.'

D E Reid (Finance Director, Tesco): it is pedantic for the finance director and auditors not to be members. The committee would be lost without them and if they are an integral part of it, they should be on the committee.

R C Tomkinson opposes the recommendation that the finance director should not be a member of the audit committee but should attend only, and points out that the American situation is not parallel because in many cases in the USA the chief financial officer is not on the board. 'It is patently absurd for a member of the board to attend a sub-committee of the board but not be able to partake in the deliberations of the committee or participate in its conclusions. This is a very serious consitutional point.'

Rolls Royce: 'We support the specimen terms of reference, but not the proposal that members should be exclusively NEDs although that will be the case in our audit committee in due course.'

V W Benjamin: whilst strongly doubting the desirability of appointing NEDs as 'monitors' over management, perceives that NEDs can without embarrassment perform a critical function in their role as audit committee members and believes management will find that acceptable. Indeed, 'audit committees are invaluable and essential. I believe they can come in a variety of shape and size. I am certain that they must have a majority of independent NEDs. I believe that the appointment of an audit committee should immediately be made a condition of listing by the Stock Exchange. This by itself presumably would impose the necessity for appointment of at least two NEDs for any listed company. The Stock Exchange regulation should be followed by legislation.'

J B H Jackson ('professional chairman'): 'Audit committees are committees of the whole board and their constitution should reflect this. Specifically they should not be committees of the NEDs. The practice in my companies is for the audit committee to comprise a majority of NEDs (one of whom should be the chairman of the committee) and at least the finance director from among the executive directors. The auditors should attend the meetings of the committee and also of the full board prior to the approval of the half year and preliminary statements, and should be free to put any remarks and questions they wish.

'If auditors need on occasion to meet the NEDs they should meet all of them (not just those on the audit committee) and make the need known through contact with the chairman of the board. If the chairman is also the chief executive such contact may not be effective and in that case only should an audit committee consist entirely of NEDs. The chairman of the audit committee would then be the balancing power the committee has suggested.

'One has to be careful about transplanting US experience into the UK scene... In the US the chief executive is often the only 'internal' member of the board. Under those circumstances their audit committees are necessarily comprised entirely of external directors.'

Midlands Industry Group of Finance Directors: 'Audit and internal control points need to be discussed with both the executive and non-executive directors to be dealt with effectively. The auditors are more likely to have a better hearing from a full meeting of the board rather than an audit committee composed of NEDs who, by their very role, may not have the depth of understanding of the detailed operations of the company.'

Sir Richard Greenbury (Marks and Spencer): 'An audit committee, when essential, should comprise both executive and non-executive directors. Indeed these functions should ideally be carried out by all members of the board, since every board member should feel responsible and is legally responsible for the company results in total.'

GKN: the text is too prescriptive on terms of reference and operation. 'It should not be essential that one meeting of the audit committee takes place each year without an executive director present.' Andrew Robb (Finance Director, Pilkington) states that there should be no subject which the NEDs wish to discuss with the auditors which cannot be discussed in the presence of their executive colleagues.

Sir David Plastow: 'I strongly feel that the membership should be made up wholly of independent NEDs and not merely a majority.'

Sir Paul Girolami (Glaxo): 'Several of the Committee's specifications will tend to generate a potential for faction.... The proposal that the audit committee should recommend the external auditor appointment and fee could have the effect of identifying the auditors with the NED group, rather than with the board as a whole.'

Geoffrey Wilson (Delta): 'It is important that the audit committee should report regularly to the board since otherwise there is some danger of it becoming a law unto itself as has I believe occasionally happened in the US. The draft terms of reference show the minutes of the committee as being tabled for the board and I believe this should also be a recommendation - otherwise there could be a situation where the chief executive is unaware of what the audit committee is doing.'

Geoffrey Maitland Smith (Sears): 'If a company chooses not to have an audit committee, as an absolute minimum the auditors should be present at the board meetings which consider the interim report and final accounts.

'There is a need for freshness among members of the audit and remuneration committees as much if not more than we would hope to see in the body of NEDs. For these two committees there should be a short term of office of, say, 3 years which can be renewed for a further 3 years.'

English China Clay: the Code should clarify that the requirement to establish effective audit committees is only 'within the next two years' (as at 4.29).

Neville Bain (Coats Viyella): a fully functioning audit committee can be implemented in less than one year. 'The committee is more effective where an internal function exists and the head of internal audit, as well as the external auditors attend. It can then programme and key findings on a regular basis. I do not agree that by having one occasion each year for the external auditors to meet solely with non-executives we create division... This is a necessary part of the checks and balances.'

Opposition to audit committees comes from Sir Owen Green:

'At best, they offer a crutch, of no legal status, to the directors not on the audit committee. At worst, they discourage other members of the board from seeking individual satisfaction in the discharge of one of the board's primary collective duties: to ensure on behalf of the shareholders a proper reflection of their governance of the enterprise expressed in published financial terms.'

'Whatever the small print, the concept of an audit committee conveys to boards, shareholders and the general public a small group of the board assuming or having vested in them responsibility for the true and fair nature of the accounts. Apart from the US precedent, there seems no reason for that subsidiarity. Further, positively to exclude certain members of the board may be or result in a breach of the fiduciary duties owed to a company by its directors.'

Sir Lewis Robertson and Geoffrey Wilson (Delta) suggest the report should make clear that the chairman of a company is eligible for membership of the audit committee if he is not also the executive head of the company. (The same point should also be clarified in relation to remuneration committees.)

Audit committee chairmen to answer questions at the AGM (4.29, final point)

The CBI do not agree that the chairman of the audit committee should answer questions at the AGM, except at the invitation of the board chairman. The IOD, Stock Exchange Listed Companies Advisory Committee, GEC, GKN, English China Clay, Courtaulds and Andrew Robb (Finance Director, Pilkington) agree the CBI line. Sir Owen Green comments 'One company, one chairman. Keep it simple.' Sir Colin Corness (Redland) states 'It cannot be right to expect an audit committee chairman, who is non-executive, to answer AGM questions on subjects about which the Financial Director is likely to be much better informed. It this trend is developed, there will be reluctance on the part of NEDs to assume the chairmanship of audit committees.' Barratt assume that the audit committee chairman would only answer questions about the actual conduct of the company's audit and that any wider chairman or the finance director. J F O'Mahoney (Finance Director, Ladbroke) makes a similar point. Courtaulds point out that a shareholder may request that his or her question be answered by a particular director, and that the chairman would have to justify it being answered by someone else.

Internal audit (4.31)

GrandMet suggest the report should go further in recommending the strengthening of the internal audit function - eg the proposed statement on the effectiveness of the system of internal financial control could be extended to include specifically the effectiveness of the internal audit function. Marks and Spencer comment that an essential element of a system of checks and balances includes an internal audit department which has unrestricted access to all directors, executive and non-executive, and vice versa. The Nationalised Industries Finance Panel and BP also emphasise the importance of internal auditors within a strong system of corporate governance and J F O'Mahoney (Finance Director, Ladbroke) stresses that they have the best overall knowledge of the company's internal control systems and are well placed to assess their effectiveness. The contribution they can make should be taken into account at 4.26.

IMI on the other hand state that effective systems of internal control can be achieved in a variety of ways often more effectively than through an internal audit department. The matter is very much related to company structure and philosophy and it should not be for the Code to prescribe the means of compliance.

Disclosure of board remuneration (4.32; Code 3.2)

The CBI support the recommendation, as do Rolls Royce. The IOD would support disclosure of the remuneration of all directors.

Cadbury Schweppes note the move to more detailed disclosure in the USA: 'it is an area where different analyses of the same results will cause confusion, so it would in our view be appropriate for the report to indicate the need for consistency in disclosure.'

Neville Bain (Coats Viyella) notes that contributions by companies to pension funds are not commented on. He says they typically vary from 35% to 75% of salary.

Marks and Spencer comment that more detail will be required before they can decide how to revise their procedures.

Sir Owen Green states that the remuneration of all directors (including those outside the UK) should be disclosed in their brackets.

Directors' service contracts (4.33; Code 3.1)

The CBI and IOD support the recommendation.

GKN want 3.1 of the Code to apply only to <u>future</u> contracts, in line with 4.33 of the text. Portsmouth and Sunderland Newspapers comment 'Our solicitors advise us that to reduce existing five year rolling contracts to three years could result in the need to pay compensation to the director... We suggest the clause is clarified to say that no new contracts should be issued to directors which incorporate a notice period of more than three years from the company to the director.'

Sir Colin Corness (Redland) says the recommendation is unclear in that it does not specify whether the period should be three years' fixed term or three years' rolling; and wonders whether there is confusion with the requirement for directors to submit for re-election by the directors every three years.

Remuneration Committees (4.34; Code 3.3, 4.7)

The CBI support the Committee's recommendations, subject to the following points:

i) the establishment of remuneration committees should be a matter of choice for boards rather than prescription;

ii) the chairman of the board should be the focal point of questions at the AGM and the chairman should only respond at his invitation.

Sir David Plastow and Rolls Royce favour a committee that is wholly non-executive.

The Stock Exchange Listed Companies Advisory Committee, English China Clay and Rolls Royce back the CBI on questions at the AGM.

The Thames Valley Commercial Group state that where the recommendations of the remuneration committee are not followed by the board, this fact should be disclosed in the accounts.

Geoffrey Mulcahy (Kingfisher), backing properly constituted remuneration committees, argues that one of the most effective ways of ensuring that shareholders' interests are protected is to ensure that directors and senior management are well rewarded over the medium term for creating shareholder wealth. V W Benjamin states that there is great benefit for shareholders from skillfully incentivised remuneration policies and that not a single institution takes the view that management should not be generously rewarded where it achieves real profit growth, measured objectively.

Duty to present a balanced and understandable assessment of the company's position (4.41, Code 4.4)

The CBI believe that the Code should be made more specific, eg by incorporating from 4.41 that the report and accounts should contain a coherent narrative, supported by figures, of the company's performance and prospects, on the basis that 'words are as important as figures'; and that setbacks as well as successes should be dealt with.

Brixton Estate would like to see proposals for simplifying the presentation of information in annual reports which it says are increasing in size and complexity to the detriment of shareholders. D. E. Reid (Finance Director,Tesco) argues that the Committee's proposals on compliance statements, statements of directors' responsibilities, expanded audit reports, and reports on going concern 'will further drown shareholders in a plethora of information.'

Operating and Financial Review (4.44)

The CBI comment that they support US-style MD&A practice, and support the voluntary approach proposed by the ASB rather than the regulated SEC approach. Sir Nigel Mobbs (Slough Estates) says it would be helpful if the Committee could convert the loose wording of a proposed OFR into a more focused code of implementation without necessarily requiring all companies to make both a qualitative and quantative forecast. V W Benjamin would like to see MD&A-style reviews more courageously recommended. Sir George Russell (Marley) says the ASB's proposals for OFRs are fundamentally flawed, and until an acceptable format is developed the second sentence of 4.44 should be removed.

Quarterly reporting (4.46)

The CBI would oppose a mandatory requirement for quarterly reporting.

Interim reports (4.47)

The CBI simply comment that additional costs must be kept to a minimum; and that any recommendation - for the sake of clarity - should be part of the Code. The IOD support the principle of more meaningful interim reporting, in particular the inclusion of balance sheet information, but are concerned that audit review will either be very expensive or give false comfort. The Midlands Industry Group of Finance Directors take a similar line.

GEC oppose any extension to interim reports on cost grounds. Courtaulds oppose it on the grounds that balance sheets can follow a seasonal pattern and movements between the half year and the year end can be misleading. They suggest that 'if the intention is to help shareholders identify a situation where a company's financial situation has deteriorated during the half year, this might be better dealt with by a requirement for boards to make an explicit statement, as part of the interim report, that no such deterioration has taken place.'

Brixton Estate state that the proposal would be particularly difficult for property companies like itself. Their investment portfolio is valued annually by external professional advisers and the cost of repeating the exercise at the interim stage would be prohibitive. Use of internal valuation at the interim stage would lead to differences of opinion and confuse the shareholders. It would be possible to use the year-end valuations at the interim stage, which might provide an acceptable degree of accuracy, but the matter should be discussed with the British Property Federation before final decisions are made.

Geoffrey Maitland Smith (Sears) welcomes the recommendation. Coats Viyella support immediate inclusion of a cash flow statement as well as balance sheet information. Cadbury Schweppes support inclusion of cash flow information now, but not review by the external auditors.

English China Clay state that 'balance sheet information' needs defining as it could refer to a level of information varying from a full balance sheet to a

Sir George Russell (Marley) opposes auditors' review of interim reports on the grounds that they cannot make any worthwhile judgement without carrying out detailed - and expensive - audit work. Properly constituted audit committees are best placed to provide reassurance on interim reports. BAT similarly oppose interim review by the auditors on grounds of cost and delay in reporting to shareholders. They suggest shareholders would be better served by an emphasis on existing information requirements - e.g. segmental analysis and comments thereon at the interim stage.

The Financial Controller of Heath Group opposes any extension of interim reports, or review by the auditors, on grounds of cost and delay.

Communication with shareholders (4.50)

Neville Bain (Coats Viyella) comments that the chairman has responsibility for ensuring that a formal programme of investor relations activities is in place and that institutions are satisfied with the programme.

Sir George Russell (Marley) states that there is a contradiction between the endorsement of regular contact between companies and their major shareholders (at 4.50) and the statement (at 6.9) that all significant statements must be made publicly so they are available to all shareholders. 'It is clearly not always possible to do both and the Committee should either clarify its intentions or provide guidance on how companies should operate in practice.'

The CBI would like to see improvement in the quality and style of communications with, and the involvement of, private shareholders. They suggest that magazines and newsletters produced for employees could be developed to send to private shareholders as well. They would welcome any initiatives and ideas from the Committee.

Pensions Governance (4.51)

The Stock Exchange Listed Companies Advisory Committee comment that this is a critical area; tougher restrictions on a company's freedom to arrange how its fund is controlled are needed and the independence of the fund should be guaranteed.

Neville Bain (Coats Viyella) suggests the Committee should comment on best practice, perhaps covering

- overt independence from the company with independent trustees and an independent chairman;

- an embargo on dealing in the company shares;

- independent management which is monitored and assessed by the trustees;

- a requirement by the company that the annual pension audit and management letter is discussed with the company audit committee.

Sir Alick Rankin (Scottish and Newcastle) states 'total separation of pension trustees from the company is not feasible until legislation or case law identifies clearly issues of ownership, responsibility and liability for the broad area of pension assets, shortfalls, management performance and funding.'

Sir Colin Corness (Redland) doubts whether there are sufficient qualified persons available to enable companies to separate completely the governance of the pension fund from that of the company itself; and questions whether it would not be sufficient for there to be independent trustees of pension funds.

V W Benjamin urges the Committee not to dabble with the subject and to drop the paragraph. 'The governance of a company's pension fund is very much a matter for the company. The pension fund is a responsibility and creature of the company and, while pensioners' interests must be fully safeguarded in every possible way, the suggestion of separate governance is very questionable. The vexed question of ownership of surplus needs to be resolved before pension governance can be correctly addressed.'

Auditing (section 5)

Professional Objectivity (5.7 to 5.9, Code 4.3)

The CBI believe that the Code should make clear that the auditors share responsibility for maintaining an objective and professional relationship.

GKN argue that the report does not bring out strongly enough the need for auditors as professional people to act at all times with integrity. If the auditor cannot obtain satisfaction when fraud by senior management is suspected, or if standards of corporate governance are so low that the interests of shareholders are at risk, he should resign.

The Stock Exchange Listed Companies Advisory Committee comment as follows:

> 'The draft report emphasises the duties and responsibilities of directors; it can be read as reducing those of auditors. This gives a most unfortunate impression which we hope will be rectified in the final report.
>
> The auditor is well placed to detect weaknesses and financial controls, and often, will identify problems in Corporate Governance. When these are detected and the company declines to take remedial action, the auditor should either include the matter in his report or resign and draw attention to the reasons for resignation. The auditor has this clear responsibility and the report should do nothing to change this. It should not be affected by the proposals to extend statutory protection to auditors making reports to the authorities in the event of fraud. There will be instances which do not justify this step but which do call for resignation on a point of principle, further action being left to shareholders.'

Quarantining of Audit Services (5.10 to 5.11)

The CBI agree that there should be no restriction on the ability of audit firms to provide non-audit services; and that fees for non-audit work should be disclosed. The IOD support the recommendation in 5.11 that the Regulations should be reviewed. The Stock Exchange Listed Companies Advisory Committee believe disclosure should extend to cover all consultancy and non-audit fees paid to subsidiaries.

Neville Bain (Coats Viyella) comments that he deplores the assumption in the public's mind that fees paid for non-audit work compromise objectivity. 'The accounting firm that audits is well placed to provide such services cost effectively..... While auditor bashing is a popular sport of the masses, it is overdone.'

Rowena Mills (member of the FRC) on the other hand feels strongly that there should be quarantining, and the Nationalised Industries Finance Panel regret the lack of a more radical approach.

English China Clay are unclear precisely what disclosure is being sought for international firms.

GEC do not believe that disclosure of non-audit fees is likely to solve any useful purpose, although they agree it is good practice for audit committees to keep them under review.

Rotation of Auditors (5.12)

The IOD support the proposal, as does J F O'Mahoney (Finance Director, Ladbroke) and the Thames Valley Commercial Group. The CBI would support a non-prescriptive recommendation for regular rotation of audit partners and managers, but do not believe that rotation should be an absolute requirement.

Sir Richard Greenbury (Marks and Spencer) says 'We understand the arguments, but believe that a thorough understanding of the client company is ultimately a more important consideration.'

Sir Owen Green opposes the proposal, describing it as a Wurlitzer process. GKN believe it is an artificial requirement which will do nothing to alleviate the real issue - lack of integrity. Cadbury Schweppes are also unenthusiastic. GEC suggest that periodic change of audit partner should be left for agreement between the board of the company, advised by its audit committee, and the firm concerned.

Statement of auditors' responsibilities (5.14)

The CBI support such statements and believe there should be a recommendation in the Code to complement 4.5. 'This would go some way to redressing the lack of balance in the Code which does not include any provisions for auditors' role in corporate governance.'

Extension of the auditors' role (5.15)

Sir George Russell (Marley) argues that the responsibilities of auditors are clearly enshrined in law and should not be extended without changes to the relevant legislation. He opposes the recommendations that auditors should report on the directors' statements regarding internal control and going concern.

GKN state that while not objecting to the proposals on internal control and going concern, 'it will nearly always be possible to draft a statement with which the auditors can concur.' GKN also express concern that the extra costs could outweigh the perceived benefits. They acknowledge, however, that the proposals have the strength of requiring directors to confront the issues.

BAT take the view that the strengthening of the quality of the existing audit process and of the responsibility of the auditors to assure the quality of the system of internal controls is fundamental. Such quality improvement is more beneficial and readily achievable than the development and appointment of a large number of NEDs.

Going Concern (5.18 to 5.23; Code 4.6)

The CBI support this provision in principle but suggest that it should be held over until the proposals have been worked out. The IOD also support in principle, whilst noting that application in practice will require very careful consideration.

The following oppose the proposal:

Sir Owen Green: 'A 'going concern' statement will predictably be all about form not substance in those few instances where it would have significance. Already one hears of negotiations between company and auditors as to the form of words mutually acceptable in problem situations. The Stock Exchange Listed Company Advisory Committee similarly believe a statement will become meaningless.

Lord Tombs (Rolls Royce): 'We are unenthusiastic. The provisions of the Insolvency Act and requirement for auditors to report whether the accounts provide a true and fair view are more than adequate if properly applied.'

Sir Desmond Lorimer: 'I fear that this will inevitably lead to auditors insisting on performing a capital adequacy audit such as would be required in the case of a capital adequacy statement as for e.g. a prospectus. If this were to happen I fear that many of the smaller firms would not only fail to obtain a clear certificate from their auditors, but would also be faced with substantial fees which could cause hardship. Again, if they do not go as far as such an audit they will have to express a subjective judgment and this in itself will, I fear, lead to conflict.'

Kingfisher: 'We have our doubts .... This recommendation will not hinder unscrupulous directors but may simply create an unnecessary burden.' BAT are similarly doubtful of the cost/benefit equation.

Brixton Estate: 'The proposal could be a highly dangerous and speculative activity, exposing the directors concerned to considerable risk of litigation. If the directors hedged their report .... to protect their own positions there is every chance that it would be assumed by creditors that the company was not a going concern, automatically bringing about the collapse of the company.'

Other comments:

Neville Bain (Coats Viyella): 'The concept is important but I do not want to see heavy guidelines with auditors making a meal of this new pasture for fee generation.'

Midland Industry Group of Finance Directors: 'An obligation could be placed on the auditors that, when they sign the year end audit report, they are effectively confirming that the company has access to sufficient funds to ensure that it continues to trade for the coming year.'

English China Clay: 'Companies will not for reasons of commercial confidentiality wish to disclose forward cashflows and internal plans in this respect.'

Cadbury Schweppes: 'Going concern statements are more appropriately dealt with under the OFR proposed by the ASB rather than in the formal Directors' Report.'

Sir Lewis Robertson: agrees that many directors do not understand the legal presumption as to a going concern basis. 'I am sure that there is a need to press for further work on this.'

C M Stuart: 'The recommendations of the report should be significantly expanded to require the accounting profession to devise a statement which can be included in published half year and full year accounts, setting out for a period of say not less than 18 months from the period end date the condition of the company's working capital resources.'

Fraud (5.24 to 5.28)

The IOD support the recommendation at 5.28, but the CBI do not: 'Claims against auditors who failed to discover and report fraud, which might be one result of statutory protection, could complicate the issue of responsibility. If auditors suspect fraud and cannot ensure its redress by the board, the proper step is for them to resign.'

Auditors' Liability (5.31 to 5.33)

The following do not support the Committee's conclusion on Caparo:

Sir Colin Corness (Redland): 'If auditors' responsibility is to be so limited, they do not deserve to be so well remunerated nor is their role so significant..... The judgment should be reviewed so that auditors remain accountable to any person who relies on their work, whenever negligence is proven.'

Sturge: 'The present situation is unsatisfactory. Public expectations are frustrated and the standing of the accountancy professions is damaged thereby. A review is urgently required.'

Sir Patrick Sheehy (BAT): the legal position following Caparo is unclear. If auditors are to play a greater role, as recommended by the Committee, then the Committee should also address whether the auditors' liability should be correspondingly increased and explain its position.

Julian Sheffield (Norcross): The decision was flawed and should be reversed by statute.

GEC note that the Committee endorse the limitation on auditors' liability in accordance with Caparo, while accepting without question the unlimited responsibility of directors.

Accountancy profession to continue its efforts to improve standards and procedures (5.34)

Sir Own Green: 'The various accountancy bodies are not constituted by law or capable in practice to achieve effective self-regulation. The enormity of recent financial scandals and the coincidental professional relationships, however innocent, make any existing self-regulatory procedures derisory. This recommendation is therefore either inappropriate or much too low key.'

Shareholders (section 6)

The CBI believe the report should give more attention to the role of shareholders, and that the Code should expressly state that institutional shareholders ought to have a policy on the use of their voting power, either by proxy or by attending AGMs, and should publish their policy. The Code could also usefully incorporate the conclusion in 6.8 (taken from the ISC guidelines) on the positive use of voting rights. This would help to produce a more balanced Code, which is at present directed solely to boards.

Sir Patrick Sheehy (BAT) comments that the report does not give sufficient emphasis to the responsibilities of shareholders, and their capacity to question management on areas of concern and compliance with best practice. David Sainsbury says it is impossible to design any system to ensure that companies have directors of the appropriate calibre unless shareholders play an active role. Cadbury Schweppes say it is essential that investors are pro-active, vote, support management, communicate any concerns and where it is appropriate, ensure changes are made via the mechanisms of meetings, AGMs, etc. The Midlands Industry Group of Finance Directors make a similar point. Sir Alick Rankin (Scottish and Newcastle) comments 'Until shareholders decide to exercise responsibility, as well as power, best practice will not ensue.'

Sir Owen Green writes: 'The concept of ownership, as distinct from membership, of a limited liability company is novel, untested, and inappropriate. The expression "owner" does not appear in the Companies Act.' GEC comment that they do not think that as owners of shares in listed companies shareholders have any responsibilities to the company as such, and that the first sentence of 6.3 is confused. In their view, shareholders have rights as owners which at their absolute discretion they may or may not choose to exercise.

GEC also comment, in relation to the statement in 6.1 that 'shareholders elect the directors', that directors are appointed by the board and then offer themselves for re-election periodically.

The IOD do not accept the Committee's ownership concept of the role of the institutional shareholders. They state 'There is no doubt that shareholders have the right to appoint and remove directors, and they should recognise that they have responsibilities over and above completing proxy forms.... However, it should be understood that control by shareholders over boards of directors can, at best, be imperfect and that the basic responsibility for corporate governance must reside in the boardroom.' The IOD also note that, whilst the support of institutional shareholders for the Code is welcomed, in the nature of things they can only express general support, as opposed to ensuring compliance.

Geoffrey Wilson (Delta) notes that in 6.8 there is a reference to the need for contact at senior executive level but there is no reference to any contact with non-executives. 'Since the non-executives are arguably the shareholders main representatives on the board that relationship is critical but is hardly explored in the report.'

Other submissions

National Grid

Letter reporting that virtually the whole of the Code is already in place and that it is the intention to move toward the adoption of the remainder of the Code as soon as administratively possible.

Paul Myners (Chairman of the Audit Committee of PowerGen, plc)

Writes to say that the Audit Committee has reviewed the report and that with a few minor exceptions (which will be addressed shortly) the company's practices comfortably meet the recommended standards.

South Western Electricity

A letter to say that the board support the Code. They believe they meet the majority of the requirements and have, where appropriate, taken steps to adopt those where a formal arrangement is not in place.

Ewan Macpherson (Chief Executive, 3i Group plc)

A letter drawing attention to the results of two surveys of more than 600 finance directors drawn from the top 1000 UK quoted companies, one published in April 1992, the other to be published in September 1992.

The results are attached at Annex E. They show that 75% of finance directors agree that there should be a code of practice. 3i conclude 'the finance directors of Britain's largest companies are well aware of the importance of good systems of corporate governance and exhibit a large degree of open-mindedness about the measures that need to be adopted to raise overall standards.'

Explaining their interest, 3i state that 'as an investor in 4,000 businesses we are dependent on board effectiveness to drive these companies forward. Even though the majority of our investments are in unquoted businesses the philosophy of corporate governance is no less relevant. Indeed we see the large company sector as a role model for the independent business and welcome visible standards being set.

'Secondly, our "Independent Director Resource" is a pool of over 300 NEDs with particular skills at working with company boards, mostly in the unquoted sector. Since 1986, 3i has introduced over 650 NEDs to positions on the boards of investee companies. Promoting good financial corporate governance is one aspect of their role.

However, we would caution against too much emphasis being placed on the NED's role as 'corporate policeman'. We are very strongly of the view that NEDs should, as far as possible, be supporters of the executive board and contributors to policy development. Indeed, one of the reasons we use experienced non-executives with relevant experience rather than place our own people on the boards of investee businesses is so that it is clear that they are there to benefit the business - not to police our investment. Our investment will benefit from a well-run business.'

Anthony Habgood (Chief Executive, Bunzl, plc)

British industry has been plagued by lack of professionalism in management, although major strides forward have been made in recent years. Industry has also been plagued by the elevation of gifted entrepreneurs to the head of major companies through a flurry of takeovers, partly facilitated by takeover rules and accounting standards.

Implicit in the report is widening the pool of non-executives and simultaneously requiring them to play a deeper role in the management of the company. This is likely to cause a dangerous reversion to amateurism.

If non executive chairmen and directors are to take a major level of responsibility for such vital areas as the strategy of the company, and essentially to set accounting standards for a company within very loose national standards, then we must really address quality and qualifications. This is alluded to in 4.7 but given no teeth, whilst 4.25 does not even scratch the surface of the problem.

If, on the other hand, the report is really about having "good men and true" to act as a check on the executive that is both necessary and desirable but should be seen and understood for what it is. Non executives need to have feasible jobs given that they inevitably have limited knowledge of the industry. To enable this to happen the first requirement is for the UK to develop world-level accounting standards, and the second is for there to be a clearly understood, recognised and accepted board structure within which they can operate.

J. C. Dwek (Chairman, Bodycote International, plc)

Lengthy submission dealing inter alia with the rules regarding resignation of auditors.

Tony Merrett and Allen Sykes

Letter reiterating some of the themes in the authors' earlier submissions to the Committee. (Summary circulated to Committee members on 6th July).

J. D. Traynor (Chairman, CRH plc, Dublin)

A view from an Irish company. Does not differ significantly from the CBI line except in opposing the Code recommendation and disclosure of remuneration (Code 3.2) - "It would be implicitly inviting shareholders and press to carry out their own evaluations". Unhappy at the emphasis on control and monitoring rather than ensuring growth, profitability, increasing value for shareholders. Also unhappy at the undue influence of the accounting and auditing professions on the report.

Norman Lindsay (Finance Director, Seafield plc, Dublin)

Another letter from Ireland. Does not believe the Committee's proposals will solve the problems. Argues that much more should be done to enhance the authority of the finance director within a company so that he is not ignored when audit firms provide creative answers to the chief executive. The role of the finance director should be properly identified and the scope of his authority set out.

ANNEX A

LIST OF RESPONDENTS

a) Representative bodies

Confederation of British Industry

Institute of Directors

Stock Exchange Listed Companies Advisory Committee

b) Company heads or another director or the company secretary on behalf of the company

Allied-Lyons (Michael Jackaman, Chairman)
Barratt (F Brown, Secretary)
BAT Industries (Sir Patrick Sheehy, Chairman)
Bodycote International (J C Dwek, Chairman)
BP (R C Grayson, Company Secretary, and C P King, Director, BP Europe)
BTR (Sir Owen Green, Chairman)
Brixton Estate (H S Axton, Chairman)
Bryant Group (A C Bryant, Chairman)
Bunzl (Anthony Habgood, Chief Executive)
Cadbury Schweppes (David Jinks, Group Finance Director)
Candover Investments (C R E Brooke, Chairman)
Coats Viyella (Neville Bain, Group Chief Executive)
Courtaulds (I W Harrison, Secretary and Controller)
CRH (J D Traynor, Chairman)
Delta (Geoffrey Wilson, Chairman)
Dixons (Stanley Kalms, Chairman)
English China Clays (P M Elliott, Secretary)
Eurotherm (J L Leonard, Chairman)
GEC (N C Porter, Secretary)
GKN (A F George, Company Secretary)
Glaxo (Sir Paul Girolami, Chairman)
Grand Metropolitan (R Myddleton, Legal Director and Company Secretary)
Grosvenor Estate Holdings (J N C James, Deputy Chairman)
Hardys and Hansons (R W D Hanson, Chairman and Managing Director)
IBM UK (D M Campbell, Secretary)
IMI (Gary Allen, Managing Director and Chief Executive)

Marley (Sir George Russell, Chairman)

Marks & Spencer (Sir Richard Greenbury, Chairman)

National Grid (David Jefferies, Chairman)

Norcros (J J L G Sheffield, Chairman)

Portsmouth and Sunderland Newspapers (T F Lake, Secretary)

Powergen (Paul Myners, Chairman Audit Committee)

Redland (Sir Colin Corness, Chairman)

Rolls Royce (Lord Tombs, Chairman)

Rowena Mills Associates (Rowena Mills, Chairman and Chief Executive)

Sainsbury's (David Sainsbury, Deputy Chairman)

Scottish & Newcastle (Sir Alick Rankin, Chairman)

Sears (Geoffrey Maitland Smith, Chairman)

Shell Transport and Trading (J A Cunliffe, Secretary)

Slough Estates (Sir Nigel Mobbs, Chairman and Chief Executive)

South Western Electricity (S A T Foster, Company Secretary)

Sturge Holdings (P A Davis, Deputy Chairman)

Unilever (S G Williams, Joint Secretary)

Vickers (Sir Richard Lloyd, Chairman)

Weir Group (Lord Weir, Chairman)

c) Top businessmen writing in a personal capacity

V W Benjamin (Deputy Chairman of Tesco and Lex Service)

Sir Ronald Grierson

J B H Jackson (chairman of four listed companies)

Sir Desmond Lorimer

Tony Merrett and Allen Sykes

Sir Lewis Robertson

C M Stuart (Chairman Designate of Scottish Power and formerly Chief Executive of Berisford International)

R C Tomkinson

Lord Watkinson

d) Finance directors writing in a personal capacity, and regional/sectoral groups of finance directors

Midlands Industry Group of Finance Directors

Thames Valley Commercial Group

Donald Main (Group Finance Director, Forte)

J C Kay (Financial Director, Gaskell plc)

J C Jeffreys (Group Financial Controller, C E Heath plc)

J F O'Mahoney (Vice Chairman and Group Financial Director, Ladbroke)

Andrew Robb (Finance Director, Pilkington)

Norman Lindsay (Group Finance Director, Seafield plc)

D E Reid (Finance Director, Tesco)

Nationalised Industries Finance Panel

Ewan Macpherson (Chief Executive 3i Group, enclosing surveys of finance directors)

GRAND METROPOLITAN PLC

MINUTE AND RESOLUTION RELATING TO THE TAKING OF INDEPENDENT PROFESSIONAL ADVICE BY DIRECTORS

2. It was noted that the Cadbury Committee had recommended in its draft Report that "there should be an agreed procedure for non-executive directors to take independent professional advice if necessary, at the company's expense". In discussion it was agreed that, although the need for such a procedure seemed never to have arisen in the past, it was nonetheless desirable in principle. However, it was also felt that there should be no distinction drawn for this purpose between executive and non-executive directors. Accordingly, **IT WAS RESOLVED** that:

1 Subject to first obtaining the agreement of either the Chairman and Chief Executive or the Deputy Chairman, any one or more of the directors of the Company may at any time obtain professional advice reasonably required in relation to the affairs of the Company or the responsibilities of a director;

2 The cost of such advice shall be paid or reimbursed in full by the Company on the authority of either the Chairman and Chief Executive or the Deputy Chairman; and

3 If the Deputy Chairman agrees to the taking of professional advice, he shall forthwith advise the Chairman and Chief Executive unless it appears to him that the particular circumstances make it inappropriate to do so.

The findings of plcUK and their pertinence to the draft report - The Financial Aspects of Corporate Governance

The following findings were taken from plcUK 7 published April 1992 and plcUK 8 due to be published September 1992. The comments are referenced to the Code of Best Practice and the appropriate plcUK survey.

Backdrop

The April 1992 survey, plcUK 7, strove to determine the importance of the corporate governance issue to Finance Directors in some of Britain's largest companies. These Finance Directors were asked their views on the UK's system of corporate governance. The importance of the issue to these executive directors is evident. Over half said that the comment "There are flaws in the system (of corporate governance) that need to be remedied if the UK's economic performance is to improve" was closest to their view. The major criticisms they levelled at the UK's system of corporate governance were the bias towards short term results, agreed or partly agreed by over 90% of the respondents, and the failure of the system to deliver adequate results, agreed or partly agreed with by 70%. Additionally, 27% thought that there were insufficient sanctions for under performance by management.

Further issues were investigated in greater detail against this backdrop and the findings that are particularly pertinent to the draft code of practice are described below.

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The Code of Best Practice

Overwhelmingly, 75% of FDs agreed that there should be a code of practice for corporate Governance. [plcUK 8]

1. Board of Directors

1.1 With regard to frequency of board meetings almost two thirds of companies hold board meetings at monthly intervals or ten times a year. Quarterly meetings are favoured by a further 14%. These tend to be the smaller companies - 70% are companies with annual turnover of less than £100 million. [plcUK 7]

1.2 Over half (51%) of the respondents thought that the separation of the roles of chief executive and chairman was desirable whilst this was only the practice in 39% of the companies surveyed. [plcUK 7]

1.3 The number of non-executive directors making up the boards varied. Over two thirds of companies had between three and six non-execs. [plcUK 7] Overall board size is between seven and ten in 53% of the companies (21% had fewer than seven and 25% had more than ten) and 70% of companies with turnover > £500 m had boards of more than ten directors. Non-executives, therefore, appear to be sufficiently represented for their views to carry weight. [plcUK 7]

82% of FDs said that a plc board should have a minimum proportion of non-executive directors. [plcUK 8]

Asked for their views on the ideal, rather than actual, size of board and the proportion of non-executives, respondents clearly favoured a higher proportion of non-executives as the size of the company increased. For the largest companies with turnovers above £1 billion nearly half of respondents favoured a board consisting of 50 percent or more non-executive directors. For companies with a turnover of between £100 million and £1 billion a majority of respondents favoured boards with a 30-50% ratio of non-executive directors. [plcUK 8]

1.4 There was widespread agreement about the main functions of the board with over 75% of respondents ranking the setting of overall corporate objectives as either the first or second most important function. Monitoring management performance was seen as the next most important ranked in the top two by 52% of FDs. [plcUK 7]

45% and 43% ranked the selection of top management and overall financial and audit supervision in the three most important functions. [plcUK 7]

2. Non-executive directors

2.1 With regard to non-executive directors bringing independent judgement to bear on board issues, plcUK respondents described the situations in which they felt non-executives made the most valuable contribution. Over 75% ranked a major acquisition or divestment in the top three situations followed by an offer being made for the company (70%) and the appointment/departure of the chairman (69%). [plcUK 8]

2.2 FDs are split 50/50 on the question of whether a non-executive director should have an equity stake in the company. Comments from respondents would seem to indicate that this split reflects the contrasting views between avoiding a conflict of interest and demonstrating commitment to the company with a modest equity stake. [plcUK 8]

2.3 Comments have not been sought on term of office. With regard to reappointment, virtually none of the companies surveyed formally reviews the performance of non-executive directors. In the few cases where there is such a review it is performed by the chairman acting alone or in consultation with other board members. [plcUK 8]

2.4 Although no views have been sought on the ability or procedures for non-executive directors to take independent advice, three quarters of FDs felt that the non-executive directors should be entitled to any information that they asked for. However, only a third said that non-executives should be given unrestricted access to all levels of management and about a quarter said that the non-executives should only be entitled to basic monthly financial data and management reports. [plcUK 8]

2.5 With regard to the selection of non-executive directors, views have not been elicited on how non-executive directors should be appointed, however, FDs do have an opinion on the most important qualifications for a good non-executive director which are: the ability to ask the right questions of the CEO and executive management (79% ranked in top three) closely followed by a track record of proven success as an executive director (78% ranked in top three). The FDs were also of the opinion that it was of much less importance for the non-executive director to have direct experience of the industry concerned or to provide business contacts. [plcUK 8]

3. Executive Directors

3.1 Directors service contracts have not been discussed in the surveys.

3.2 Opinions on the disclosure of directors emoluments has, likewise, not been surveyed.

3.3 Across the survey, 83% of all companies already have a remuneration committee and non-executive directors sit on 85% of these. As the size of the company increases so does the proportion with a remuneration committee - 93% of companies with turnover >£1 billion have such a committee. [plcUK 8]

4. Controls and Reporting

4.1 On average 62% of companies surveyed have an audit committee with non-executive directors represented on two-thirds of these. However, the proportion with an audit committee increases with company size - less than half (47%) of companies with turnover < £100 million have an audit committee rising to over three quarters (77%) in companies with turnover > £1 billion. [plcUK 8]

4.2-4.7 No survey questions have specifically addressed the reporting requirements of boards.

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Other issues of note

Involvement of shareholders

Chapter 6 of the Draft Report discusses the formal relationship between the shareholders and board of directors and raises the issue of how to strengthen the accountability of boards to shareholders.

PlcUK respondents were strongly against more direct institutional shareholder involvement in the business. For example 82% were against institutional shareholder representation on audit committees, 78% were against representation on compensation committees and 78% were against their involvement in board appointments. Nevertheless, despite this understandable resistance on the part of FDs to what many see as 'interference' by institutions, it should not be overlooked that about one in five were prepared to support even these methods of ensuring greater management accountability. [plcUK 7]

Many accepted that the trend towards forming closer links between management and institutional shareholders would probably continue and that this was desirable. (Over 60% of plcUK 1 respondents perceived that institutional investors were gaining influence.) However it did pose certain problems including the growing risk that the interests of individual shareholders might be sacrificed. (Individual private shareholders represented 25% of the ownership of plcUK 4 respondents companies compared with 62% in the hands of institutional shareholders.) 55% of the survey respondents agreed that this was a risk.

The May 1991 survey, plcUK 4, investigated the attitudes towards shareholder relations programmes. The major objectives for these programmes were seen as securing support for management objectives and helping ensure that the company's share price fully reflected the value of the company. (In plcUK 1, over 60% of FDs felt that their company was undervalued.) Both of these were regarded as being of major importance by over 80% of the respondents. Additionally, a significant minority, 40%, said that a third important objective of shareholder relations programmes was to help ensure the rejection of possible takeover bids. [plcUK 4]

When asked about the most effective means of communicating with shareholders, face to face meetings were considered to have a major impact on shareholder relations by over 95% of respondents. Analyst meetings were considered to have a major impact by a further 66%.

With regard to the role of non-executive directors, plcUK FDs do not think that it is, or should be, the role of non-executive directors to monitor the interests of these institutional investors. [plcUK 8]

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Conclusion

The Financial Directors of Britain's largest companies are well aware of the importance of good systems of corporate governance and exhibit a large degree of open mindedness about the measures that need to be adopted to raise overall standards. The Committee on The Financial Aspects of Corporate Governance can be heartened by the general levels of both awareness and acceptance of these issues in board rooms across the country.