

## COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE

### Chairman's Brief for the Meeting on Wednesday 8 December 1994

#### 1. Apologies for Absence

None received to date from Committee Members **but** sincere apologies from the Secretary who will be well on the way to Grenada by the time the meeting starts!

#### 2. Minutes of the Last Meeting

These have been circulated and we have received one request for an amendment from Martin Taylor. This has been circulated to Committee members and you just need their formal agreement to the amendment.

I have checked the minutes of the 14 September meeting and there are no matters arising.

#### 3. Internal Control

Paul Rutteman will join the meeting at this point and will be accompanied by the Working Group Secretary, Richard Chinn, another member of the Group and a member of the APB's working party. (I have been promised names for these two by Monday).

Mr Rutteman has summarised what the Working Group needs from the Committee in the final paragraph of his letter. I think that the Committee will have to give a definite view on both issues raised - the Working Group obviously does not feel it can proceed having a split of opinion amongst its own membership.

#### 4. Issues for the Committee's Successor Body

It might be useful before discussing this item to ask Sir Sydney Lipworth to give a verbal update of the FRC's progress towards the establishment of the successor body. I understand, unofficially, from Sydney Treadgold that the discussion at the FRC on 22 November was to some extent inconclusive, but that there was agreement that they should consult with other sponsors. This is now being put in hand. Sir Sydney's leaning is towards keeping the existing Committee format, with a roll-over of membership, and also a limited remit, with the option of expanding it at a later date.

I would welcome some indication from Committee members that they are happy with the format in which the issues for the successor body are presented. As it stands, the paper covers the bare bones and could be filled out with a lot more detail if so wished.

You may wish to draw attention to the proposal contained in Sarah Brown's letter of 10 November for a DTI team to make a presentation to the Committee on the review of company law. I suggest that they should be invited to attend the Committee meeting on 7 March.

5. Monitoring Compliance

This item is mainly to keep Committee members who are not on the Monitoring Sub-Committee up to date with the developments on the monitoring exercise. The statistics are very encouraging.

6. Publication of survey results.

When this was discussed at the Monitoring Sub-Committee there was general agreement that it was essential for the results of the survey to be published, with no restriction on their circulation. However, they felt that such a decision should be made by the Committee as a whole. I consider that there would have to be some very strong arguments made for an opposing view to prevail.

7. Disclosure of Directors' Share Options/UITF 10

While, as I understand it, the DTI are still considering the approach from the ASB on UITF Abstract 10, it would be inappropriate for the Committee to step in. Similarly, we could only amend the Code of Best Practice after first consulting with the Stock Exchange to ensure that they were content with the effect it would have on their continuing obligation for listing. The comment I read in Accountancy Age referring to "buck passing" in relation to this issue seems very relevant! I don't think that it should rest with the Committee.

8. Companies with Debt Listings

This is another subject which was considered by the Monitoring Sub-Committee and referred to the full Committee for decision. It is an area over which I have always felt confused (mainly because of my ignorance of the detail of different listing requirements). The paper was prepared in conjunction with David Porteous of the Stock Exchange's Listing Department.

I would suggest that a decision should rest between options (a) and (b), and that the situation should not be allowed to drift on as it would do under (c).

9. Arlen plc

Arlen are the one company who are known to have made an inadequate compliance statement. Sir Andrew Hugh Smith was strongly of the view that the institutional investors should be made to take action when a company in which they invest makes such a statement. We do not know of course whether the investors have taken any action as a result of Sir Andrew's discussion with the ABI. However, it would not seem unreasonable for a short letter to them to remind them of their obligations.

10. Mr J Gillum

This item should not take up too much time, as I do not think that the current Committee can take forward Mr Gillum's proposals in any way. I put it on the agenda for two reasons, firstly to let Committee members know that we still received this type of correspondence and the Committee are still perceived as the authority in this area (in this case it should more correctly be addressed to the ASB I think); and secondly a person such as Mr Gillum was unlikely to be satisfied with anything other than an assurance that his papers had been passed to the Committee for consideration.

Gina Cole  
1 December 1994

**COMMITTEE ON THE FINANCIAL ASPECTS  
OF CORPORATE GOVERNANCE**

**Minutes of the meeting held on Wednesday 7 December 1994  
at the London Stock Exchange**

**Present:**

Sir Adrian Cadbury  
Sarah Brown  
Jim Butler  
Jonathan Charkham  
Hugh Collum  
Sir Dermot de Trafford  
Andrew Hugh Smith  
Andrew Likierman  
Sir Sydney Lipworth  
Nigel Macdonald  
Mike Sandland  
Mark Sheldon  
Martin Taylor  
Sarah Andrews

**Also in attendance for Item 3:**

Philip Ashton  
Richard Chinn  
Paul Rutterman  
Mike Townsend

**Agenda Item 1**

1. There were no apologies for absence

**Agenda Item 2 - Minutes of the last meeting**

2. The Chairman advised that a request for an amendment to paragraph 9 under Agenda Item 2 had been received from Martin Taylor. It should now read :-

"Martin Taylor said there might be a danger that companies' boards would specifically say that they had no legal responsibility for the effectiveness of the internal controls since they would believe that if they did not make such a statement it would be assumed that they were vouching for the effectiveness and that this would expose them to greater risk of liability, particularly in the USA."

No other requests for amendments had been received.

### **Agenda Item 3 - Internal Control**

3. Paul Rutterman introduced the issues on which concern had been expressed in response to the revised draft of guidance. The first on the definition of a reportable weakness had been resolved by the Working Group. The second arose in connection with expressing an opinion on the effectiveness of systems of internal financial control.
4. A majority of the responses received by the Working Group were against encouraging boards to express a view on the matter; they included a number of companies, the CBI, major audit firms, ICAEW, APB and the Law Society. Their main concerns were potential exposure to legal liability and giving unwarranted assurance. Organisations which might be said to reflect the consumer interest, plus ACCA, ICAS, CIPFA, IIA and the Bank of England found the proposed wording too weak. The Working Group were divided with a majority in favour of encouragement.
5. A constructive debate among Committee members followed. Points against encouraging an expression of opinion on effectiveness included:-
  - such an opinion could give rise to a liability or to the perception of one;
  - auditors would have difficulty in reporting on such expressions of opinion; a letter from the major firms' heads of audit said "it would be difficult for us to distance ourselves from their (the directors') opinion, to do so would at best involve some rather clumsy wording; at worst it would appear negative".
  - if directors were sued for negligence, a collective statement on effectiveness could weaken their case;
  - the legal position in jurisdictions outside the UK needed to be taken into account;
  - it was hard to envisage what form of words a director could safely use (examples would help);
  - the Report and the Code had focused attention on internal financial controls, would much be gained by encouraging expressions of opinion?
6. Those who supported what had been referred to as the consumer interest made the following points:-
  - The lack of effective internal financial controls had been one of the main reasons for setting up the Committee;
  - the aim of reporting on effectiveness should remain a goal and the issue was how best to make progress towards it;

- by encouraging expressions of opinion, possible ways forward could be identified and it was hard to see how this could be done without practical experience to build on;
  - companies were to be encouraged, not required, to express an opinion; it might be that large companies would make a statement, medium-sized companies would only act on professional advice and small companies would ignore the matter; this could still provide a useful basis for the successor body to determine its policy on effectiveness.
7. Much of the debate centred on the legal issues involved. It was suggested that provided the directors had taken the appropriate steps to establish that their system gave reasonable assurance of effectiveness, a failure within the system would not of itself render them liable. It did not seem to be feasible to seek an overall legal opinion on whether new liabilities could be created by the proposal, as the legal position would have to relate to the circumstances of the company concerned.
  8. There was also discussion about how opinions on effectiveness might be expressed. The statement should describe the process, refer to the way in which benefits had been weighed against costs and make clear that only reasonable assurance could be given. Bland statements should be discouraged. It would be helpful to study examples of US forms of wording.
  9. In conclusion, the majority of the Committee were in favour of retaining the aim of reporting on effectiveness. Statements on effectiveness would test opinion on the matter and provide guidance to the successor body. Given the reservations of directors and auditors, the Working Group was asked to consider a form of words which would leave it open to boards to follow their own judgment in the matter, while still making it clear that expressions of opinion on effectiveness would be welcome.
  10. Whatever form of words was finally agreed, following the Working Party's guidelines would constitute compliance with the Code.

#### **Agenda Item 4 - Issues for the Successor Body**

11. Sir Sydney Lipworth reported on the progress made by the FRC over the future of the Committee. It had been agreed that there should be a successor body and that it should be a continuation of the existing committee with the addition of new members and under a new chairman. Its remit would be determined by its sponsors, who were at present FRC, LSE, CBI, IOD, and the accountancy profession. Sir Sydney was looking to include representation from investors among the sponsors and aimed to complete his discussions with them by the end of January.

12. It was felt important to be clear where ownership of the Code and the ability to change it would lie. Equally, the committee should avoid becoming a body which made rulings on the application of the Code along the lines of the Takeover Panel. It was pointed out that the monitoring exercise itself would bring out issues for the new committee's agenda and that directors' remuneration would have to be addressed. The committee would pick up items as they arose, but already had a heavy prospective workload in terms of the list prepared by the Secretary.
13. The list was welcomed and the next stage would be to group the items on it and allocate priorities. One of the roles of the committee could be to bring some of the wider issues, such as the investment policies of the institutions and shareholder involvement in general, to a point where they could be usefully debated more widely.
14. The present Committee had broadened out from its original remit, but had done so incrementally. While there was logic in widening the terms of reference, any extensions of the new committee's activities would have to command the support of the sponsors.
15. The DTI had responded to the Committee's enquiry about progress on the recommendations requiring changes to the Companies Acts and the offer of a presentation at the start of the March meeting was warmly welcomed. The DTI were bringing out a green paper on directors' fiduciary duties in March.

#### **Agenda Item 5 - Monitoring compliance with the Code of Best Practice**

16. The interim report on monitoring compliance with the Code was judged to provide an encouraging picture of the response at this stage to the Committee's recommendations and would provide the benchmark against which to judge future progress. The Monitoring Sub-Committee were asked whether it would be possible to gauge in any way how far institutional shareholders had responded to the recommendation that they should make their policies on voting known.

#### **Agenda Item 6 - Publication of Survey Results**

17. The committee strongly supported full publication of the survey results, but pointed out the importance of doing so in a positive way. We had an encouraging picture to present and need to stress that the measure of success was disclosure rather than, at this stage, compliance.

## **Agenda Item 7 - Disclosure of Directors' Share Options/UITF 10**

18. A request had been received from the major accounting firms, but not from the ASB/UITF, "specifically to endorse the UITF guidance" as giving effect to the Code's recommendations. While welcoming the UITF guidance on a complex matter, this request would take the Committee beyond its own recommendations (which did not cover all directors individually) and it was not in a position to give rulings on the application of the Code. The chairman would reply along those lines.

## **Agenda Item 8 - Debt-listed only companies**

19. The Committee agreed with the guidance given by the Secretary over debt-listed companies and endorsed actions a) and b).

## **Agenda Item 9 - Arlen plc**

20. It now appears that Arlen is likely to comply in future and there had been investor pressure for them to do so.

## **Agenda Item 10 - Letter from Mr J R Gillum**

21. Mr J R Gillum's letter was noted and the Chairman was asked to reply. The Committee could not become involved in the detailed agenda of audit committees, but Mr Gillum's case study could usefully be drawn on in training courses for directors.

## **Agenda Item 11 - Any other business**

22. The request by UKSA for endorsement of their proposed remuneration enquiry was turned down and the chairman was asked to write accordingly.

## **Agenda Item 12 - Date of next meeting**

23. The next meeting will be held at 3.00pm on Tuesday 7 March 1995, at the London Stock Exchange.

CAD-02285

**COMMITTEE ON THE FINANCIAL ASPECTS OF  
CORPORATE GOVERNANCE**

The next meeting of the Committee will take place on Wednesday 7 December 1994 at 3.00 pm, in the Board Room, 23rd Floor, the London Stock Exchange, London EC2N 1HP.

Agenda

- 1. Apologies for absence. ✓
- 2. Minutes of the last meeting held on 14 September, previously circulated. ✓
- 3. Internal Control: Results of the Exposure of the Revised Draft of Guidance to Directors of Listed Companies. Presentation by Paul Rutteman, accompanied by a member of the Working Group and a member of the APB Working Group. Copy of Mr Rutteman's letter to the Chairman dated 25 November 1994 attached.
- 4. Issues for the Committee's Successor Body - CFACG(94)4 attached.
- 5. Monitoring compliance with the Code of Best Practice - CFACG(94)5 attached.
- 6. Publication of Survey Results - CFACG/(94)6 attached.
- 7. Disclosure of Directors' Share Options/UITF 10 - CFACG(94)7 attached.
- 8. Debt-listed only companies CFACG/(94)8 attached.
- 9. Arlen plc - CFACG(94)9 attached.
- 10. Letter from Mr J R Gillum - CFACG(94) 10 attached.
- 11. Any other Business.
- 12. Date of next meeting - Tuesday 7 March 1995 at 3.00 pm.

Gina Cole  
Secretary  
29 November 1994

**COMMITTEE ON THE FINANCIAL ASPECTS  
OF CORPORATE GOVERNANCE**

Proposed amendment to the minutes of Committee Meeting held on 14 September 1994

The Secretary has received the following proposed amendment to paragraph 9, under Agenda Item 2, to the minutes circulated under cover of her letter of 23 September:-

Delete:"Concern was expressed by Martin Taylor that no company would say that they did not accept responsibility for the effectiveness of the internal controls, especially if their accounts were being published in the US."

Insert: "Martin Taylor said there might be a danger that companies' boards would specifically say that they had no legal responsibility for the effectiveness of the internal controls since they would believe that if they did not make such a statement it would be assumed that they were vouching for effectiveness and that this would expose them to greater risk of liability, particularly in the USA."

Gina Cole  
Secretary  
23 November 1994



**Department of  
Trade and Industry**

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Secretary  
Committee on the Financial Aspects of  
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Our ref

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Date 10 November 1994

Dear Gina,

Thank you for your letter of 26 October enquiring about progress in implementing the three recommendations in the Committee's report addressed to the Department.

**Directors' service contracts not to exceed three years without shareholder approval**

As part of our programme of reviewing company law, we set up a working party last year to examine the law on directors' duties - in particular, directors' fiduciary duty to act in good faith in the interests of the company, the duty of care and skill, and the rule of equity which states that a director may not make a personal profit from any transaction with the company other than by way of his lawful remuneration. The working party is also examining the detailed provisions of Part X of the Companies Act (sections 311 to 347) which in effect restate the equitable rule in respect of specific matters such as loans to directors, directors' service contracts, and directors' dealings in their company's shares. A consultation document is in an advanced state of preparation and if all goes well it will be issued early in 1995. It will specifically invite comments on the Committee's recommendation that section 319 should be amended so as to require shareholder approval for service contracts in excess of three years.

As Nigel Peace said in his letter of 12 September to Sir Adrian Cadbury, we should be very pleased to make a short presentation about the consultation document to the Committee once it has been issued, if the Committee would be interested.

**dti**





### Disclosure of fees paid to audit firms for non-audit work

Preliminary research that we have undertaken has shown that many companies are going beyond the existing statutory disclosure requirements and are complying voluntarily with Cadbury's recommendation that fees paid for non audit work should be fully disclosed both in a UK and, where appropriate, worldwide context. However our research also shows that the diverse international structure of the auditing firms will make it difficult to draft regulations that would apply consistently. We intend to consult next year, reviewing current practice and possible options (both regulatory and through encouraging best practice) so as to ensure that the spirit of the recommendation is met.

### Statutory protection for auditors reporting fraud

Informal consultation has suggested that many auditors do not appreciate the extent to which there is already legal protection for those reporting fraud in the public interest. The Auditing Practices Board will shortly be publishing a new standard on fraud and error which will explain more clearly and accessibly the scope of the existing protection and the circumstances in which auditors should report suspected fraud. (The Board has already published standards on reporting to regulators.) The Department will consider, in the light of experience with the new standard, whether this meets the need identified by the Committee or whether further protection is needed; if so, primary legislation would be required.

Yours sincerely

*Sarah E Brown*

**SARAH E BROWN (Mrs)**  
**Head of Companies Division**