

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

**Minutes of the meeting held on Wednesday 14 September 1994  
at the London Stock Exchange**

Present: Sir Adrian Cadbury  
Jim Butler  
Jonathan Charkham  
Sir Dermot de Trafford  
Andrew Likierman  
Nigel Macdonald  
Mike Sandland  
Martin Taylor  
Gina Cole

**Agenda Item 1**

1. Apologies for absence were received from Sarah Brown, Hugh Collum, Sir Andrew Hugh Smith, Sir Sydney Lipworth and Mark Sheldon. The Chairman advised that Sarah Brown had succeeded Arthur Russell as Head of Companies Division in DTI and would be acting as Observer to the Committee.

**Agenda Item 2 - Minutes of the Last Meeting**

2. The Secretary advised that a request for an amendment to paragraph 11 had been received from Sir Sydney Lipworth. The second sentence of this paragraph should now read:-

"Sir Sydney Lipworth added that he considered the broad objective of paragraph 4.5 of the Code was not to require an absolute guarantee or warranty of the effectiveness of the internal controls, but that a statement to the effect that the directors had satisfied themselves as to the adequacy of the controls would comply with the spirit of the provision."

No other requests for amendments had been received.

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

3. The Chairman referred to the main changes listed by Paul Rutteman in the letter covering the Revised Exposure Draft on Internal Control. He was in agreement with paragraphs one and two. The third paragraph concerned the way in which directors of companies might express an opinion on "effectiveness". The Chairman drew attention to Sir Sydney Lipworth's letter to him of 8 September, previously circulated to Committee members. A copy of a letter from Mark Sheldon, in response, was tabled. The Chairman said that in his view, "reporting on" the effectiveness of a system of internal control by directors would signify taking responsibility. He considered that the Committee had not intended directors to assume any additional burden, but had aimed to clarify existing responsibilities. The Committee itself does not have authority and there was a consequent need to preserve the general standing of the Code, and not place the Committee in an adversarial position vis a vis the profession.

4. Jonathan Charkham said that, putting the legal position to one side, one should ask what is actually wanted of directors. If it is to address the issue of internal control and exercise reasonable diligence, they can do this firstly by satisfying themselves that there is a system, and secondly by ensuring that it is adequately staffed. It would be unreasonable to go further than this, but it leaves the question of how it should be reported. Martin Taylor suggested that one way of approaching this was to say that you have reported on the internal control system, as had been done by SmithKline Beecham. It was pointed out by Jim Butler that paragraph 3 of the guidance that directors are "encouraged" to state their opinion on the effectiveness of the system of internal financial control.

5. The Chairman raised the question of whether the Code would need revision, and this option would have to remain open for the successor body. The wording of any endorsement of the guidance would need very careful drafting.

6. The following points were made by Nigel Macdonald. He was in agreement that the Code should not be changed at this stage, but it was reasonable to acknowledge that it needed revision and that the Committee would encourage its successor body to do so. Secondly, he referred to the Committee's original remit, and the fact that the Committee should not be confined to saying things which are currently within the law. He felt that the revised exposure draft was not only an improvement, but endorseable by the Committee. Any such endorsement should include a reference to the fact that this is an evolving area, and as Mark Sheldon pointed out in his letter, an interim process.

7. In view of the fact that the proposed guidance was to be introduced with effect from 1 January 1995 and could be subject to review by the Committee's successor body from June 1995, Andrew Likierman said he felt no discomfort with it. The Chairman said it would be sensible for the successor body to look at the Code as a whole, and make any changes necessary in one go. He felt that there was support for what the Committee was trying to get across, and that the current guidance was a move in the right direction. It should be up to the review body to decide how the Code can best reflect the proposed statement and how it evolves in practice.

8. The need for a positive response to the draft was highlighted by Mike Sandland. He said that the Committee should maintain support for 4.5 as the long term objective, while recognising that the guidance does not meet 4.5 as it stands, although it would, as an interim measure, meet both the Committee's and the Stock Exchange's requirements.

9. The following form of words for an endorsement was proposed by Jonathan Charkham:-

"The Committee feels that paragraph 4.5 requires further consideration and will not insist on companies reporting on it in the terms suggested. It is pleased, however, to give full support to the statement of principals set out by the accountancy profession and recommend that companies cover the subject in these terms in their report on corporate governance".

Nigel Macdonald suggested that in addition, the Committee should express their gratitude for the work put into what was no easy task. He suggested the following form of words:-

"The Committee believes that the guidance is fully consistent with the spirit of paragraph 4.5, including the reporting requirement as to responsibility and descriptions of key procedures, notwithstanding that the statement as to effectiveness called for by the Code is, under the guidance, only encouraged, rather than required by them."

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. Jonathan Charkham felt that no director could express more than "a reasonable assurance" of the effectiveness of a system. Cost-effectiveness had to be considered.

10. The Chairman agreed to draft a form of words which would be circulated to Committee members for comment. He accepted Mike Sandland's proposal that any such wording should be as concise as possible, but it was a question of ensuring that it was watertight. Complete compliance with paragraph 4.5 would be put "further ahead" in the evolutionary process, rather than "on one side". He agreed that the

line the Committee was taking could be seen by outside interested parties as backtracking, but not as something about which the Committee should be unduly worried. It was Nigel Macdonald's view that the Committee would be subject to greater criticism if it were seen to hide behind the law rather than face up to issues. It was agreed that any form of wording would need Stock Exchange approval.

#### **Agenda Item 4 - Going Concern**

11. The Chairman welcomed the guidance and referred to paragraph 20. He advised those present that the APB were currently considering the final draft of their guidance for auditors, but understood that a difference of interpretation of the need for any additional disclosures might emerge. He welcomed the explanation in paragraph 55 regarding the going concern statement in respect of both the parent company and groups as a whole.

12. There was general support for the document and it was pointed out by Nigel Macdonald that if the going concern and internal control documents were published at the same time, any endorsements given to them by the Committee would need to be similar, in that any differences between the two would be picked up. The Chairman agreed and suggested that the Committee should propose a statement, together with a brief note to be used as a foreword in both cases.

#### **Agenda Item 5 - Labour Party document**

13. The Chairman said that he had asked for this document to be circulated, although there was no need for the Committee to get involved at this stage. He had taken up the question of whether a unitary board could turn itself into a two-tier board under current law, with Nigel Peace at the DTI. A copy of his response was circulated to those present. He drew attention to the third paragraph on page 2, in which it was pointed out that a statutory basis for unitary boards may not be universally welcomed.

14. Jonathan Charkham said that his understanding of the Labour Party document was that it was very much a first shot, and that no policy had yet been cast in stone. Martin Taylor suggested that there may be developments before the end of the year on the proposals for the draft Fifth Company Law Directive. The CBI is considering whether they would wish to lobby the Government on this, he is aware that a number of large firms are supportive of the draft.

#### **Agenda Item 6- Monitoring Compliance**

15. The Secretary advised that there was no written update on companies' compliance with the Code, and that the Sub-Committee meeting planned for 12 September had been postponed. This had been due to the fact that the database at the ABI had become corrupted and all information was having to be re-inputted. She

had been assured by the ABI that the situation would not recur. It was hoped that a full report (which would include nearly all the companies in the sample) would be available at the end of October.

#### **Agenda Item 7 - Any other business**

16. The Secretary drew Committee members' attention to the recently published consultative document on the Alternative Investment Market (AIM), published by the Stock Exchange. The USM is due to close at the end of 1996. She had been advised by Stock Exchange staff that by then it was likely that up to 90% of USM companies will have transferred to a full listing.

17. The Alternative Investment Market will be far less regulated than the USM, and the approach will be very much "caveat emptor". Some companies may pass through AIM to a full listing, while others may remain in the smaller market. The proposals for admission to AIM, as they stand, do not require companies to make a statement of compliance with the Code of Best Practice. She had been assured that the Exchange would ensure a clear differentiation between the AIM and the Official List. She invited Committee members' views as to whether they were happy with the Consultative Document as it stood, or whether the Committee should press for a compliance statement to be a condition of admission to the AIM.

18. After discussion, it was agreed that it would be preferable to accept the Exchange's proposals as they stand. The Secretary will ask that in any guidance, the Exchange should make it clear that companies ought to aim to comply with the Code as far as possible.

19. Jonathan Charkham raised the related issue of how to deal with larger companies who do not at present have to make a compliance statement, and agreed that it was something to be tackled by the successor body.

#### **Agenda Item 8 - Date of Next Meeting**

20. The next meeting will be held at 3.00 pm on Wednesday 7 December 1994, at the London Stock Exchange.

Gina Cole  
Secretary  
22 September 1994