

MINUTES OF MEETING 7/12/94

1. No apologies.
2. Minutes agreed subject to Martin Taylor's amendment.
3. Paul Rutteman 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.

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.

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?

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.

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.

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.

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 judgement in the matter, while still making it clear that expressions of opinion on effectiveness would be welcome.

Whatever form of words was finally agreed, following the Working Party's guidelines would constitute compliance with the Code.

4. Sir Sydney 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.

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.

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.

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.

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.

5. 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.

6. 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 needed to stress that that the measure of success was disclosure rather than, at this stage, compliance.

7. 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 in a complex field, 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.

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

9. It now appeared that Arlen was likely to comply in future and there had been investor pressure for them to do so.

10. 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.

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

TO NIGEL MACDONALD  
Ernst & Young.  
071 931 3807.

Nigel/ Most grateful for  
your help & advice (a fax!)  
Adnan.