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Secretary  
Committee on the Financial Aspects  
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31 July 1992

36/MRH/jemc

Dear Sir

**The Financial Aspects of Corporate Governance**

We have considered the Cadbury Committee's draft Report on The Financial Aspects of Corporate Governance and enclose a copy of our response on the issues raised and the Committee's Recommendations.

We look forward to receiving the Final Report detailing the Committee's conclusions.

Yours faithfully

A handwritten signature in cursive script that reads "Stoy Hayward".

Stoy Hayward

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2226.mrh.jemc

Stoy Hayward - South East Firm

Offices in London, Beckenham, Brasted, Chelmsford, Epsom, Newbury, Reading, Richmond, Ware and Wembley

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1. **CODE OF BEST PRACTICE (pages 42 and 43 and paragraphs 3.1 to 3.17)**
  - 1.1 The Code of Best Practice is the central part of the Committee's recommendations and we support the approach to establishing such a model code. We believe, however, that the following matters should be taken into account.
  - 1.2 We believe the Code does not sufficiently provide guidance on the detailed implementation of it and must be capable of support by companies generally. Essentially, the Code sets out the principles of good corporate governance; however, any further guidance provided should allow some flexibility to allow for the differences in companies' needs.
  - 2.3 The Code does not detail the sanctions available in the event that a company does not comply with its requirements. Is it intended that a well run company which is financially sound and of good repute should have its quotation removed because of its failure to comply with an aspect of the Code. Care will be needed to ensure that it is not too prescriptive.
  - 1.4 We believe that the UK concept of a unitary board is of paramount importance with all directors being responsible for the management and stewardship of a company. The Code, of course, does not readily match with this concept as it refers to separate responsibilities for executive and non-executive directors, and essentially moves towards the continental two-tier board system. We do not believe this provides for unified and collectively responsible boards of directors.
  - 1.5 We concur with the principles of the Code being based on openness, integrity and accountability. Without these essential ingredients, the business community as a whole will suffer and the confidence required will be lost. More information and balanced reporting will ensure users will be better prepared and able to make relevant judgements. (Paragraphs 3.2 to 3.5)

**1. CODE OF BEST PRACTICE (continued)**

- 1.6 Little guidance has been given as to the precise form of the Statement of Compliance and we believe further information should be provided to enable directors to consider what is expected of them. It may be that a proposed form of Statement should be provided to assist in this respect. (Paragraph 3.7).
- 1.7 We do not believe that Auditors should be required to review a Statement of Compliance by directors. The role of Auditors has been to report on financial and other related matters, assessing management's judgement in that process. A requirement for Auditors to review Compliance with the Code would widen their area of responsibility and potentially create further difficulties as regards the "expectation gap". (Paragraph 3.10)
- 1.8 One of the Committee's recommendations is for Statements of Compliance to be published in financial statements for the year ended 31st December 1992. We believe that further debate and deliberation is required before finalisation of the Code and would suggest a later deadline of 31st December 1993. (Paragraph 3.7)
- 1.9 We are not convinced that the proposed Stock Exchange listing requirement is appropriate. Our uncertainty is based on the lack of guidance on how failure to comply with the Code will be regarded. There may be circumstances where on the one hand minor breaches arise and on the other significant breaches, but in a well regulated and managed company. How are these to be regarded - should both be de-listed, or should shareholders be allowed to take the appropriate action? (Paragraph 3.8)
- 1.10 We agree that the Code should be subjected to regular review and believe that some Standing Committee should be appointed to perform that function. (Paragraph 3.13)

## **2. THE BOARD**

### **2.1 The unified Board**

- We concur with the general statements made in relation to the need for every public company to be headed by an effective board to lead and control and business. We also agree with the view that the board should comprise both executive and non-executive directors. We do not support, however, the proposals to widen the responsibilities of non-executive directors to such an extent that the collective responsibility of boards is lost and the possibility of divisiveness between executives and non-executives creeps in. We also believe that without careful prescription of the responsibilities and duties of directors generally and individually, the public's perception of the role of and expectation of directors will not be enhanced. (Paragraphs 4.1 to 4.3)
- Reference is made to the tests of board effectiveness by reviewing the way in which they work together and to the fact that all directors are responsible for the board's actions and decisions. We believe the proposals preclude both of these principles being effective. (Paragraphs 4.2 to 4.3)

### **2.2 The Chairman and Chief Executive**

- We support the view that the roles of Chairman and Chief Executive should be separated. We acknowledge, however, that company boards may, where appropriate, wish to combine the roles. Directors of a company should, in considering the appointment of the relevant individuals to these positions, ensure appropriate balance is maintained. It may be that a non-executive director is appointed as Chairman to exercise any necessary check on a strong Chief Executive; however, that should be the decision of the board as a whole and not in any way prescribed. (Paragraphs 4.4 to 4.6)

**2. THE BOARD (continued)**

**2.3 Board Structures and Procedures**

- We agree that directors should meet on a regular basis and that there should be a formal schedule of matters reserved to them for their collective decision. We believe, however, that the schedule of matters should be significantly greater than those detailed in paragraph 4.20 as this narrows the role of the board as a whole and provides greater opportunity for divisiveness. The full board should review and consider in detail all aspects of effective management of the company and should delegate any aspect of their duties and responsibilities as they feel appropriate. A proper and full record of those meetings should be maintained clearly indicating views expressed and any differences of opinion. (Paragraphs 4.19 and 4.20)
- We support the view that boards should recognise the importance of the finance function and ensure that it is the responsibility of a main board director. That person should also be a member of any Audit Committee formed and be a signatory to the financial statements. (Paragraph 4.18)
- We also believe the Company Secretary has a key role to play in ensuring the board procedures are followed and reviewed. (Paragraph 4.21)

**2.4 Non-executive directors**

- Reference is made to the "calibre and number" of non-executive directors, that their views should carry "significant weight" and bring an "independent judgement to bear on issues of strategy, performance, resources .....". Each of these sentiments is clear and ones with which we would agree. (Paragraphs 4.7 and 4.8)

**2. THE BOARD (continued)**

**2.4 Non-executive directors (continued)**

- The context in which these references are made is, however, not to demonstrate the importance of their role as one of the directors, but to emphasise and enhance their role to one of "super-directors".
- We do not consider the Committee's recommendations in relation to non-executive directors to be appropriate as they would not support the concept of a unitary board and prove divisive as between executive and non-executive directors. The Draft Report made no reference to any review of the responsibilities and duties of directors and thereby more clearly define each director's role (and, as a consequence, legal liability). Without that it is difficult to see how the roles of executive and non-executive directors can be distinguished so as to ensure on the one hand that delegated responsibilities and duties are clear, but on the other that collective responsibility is maintained.
- We do not support the view that non-executive directors should monitor the executive management, as will be clear from our above comments. Any such move would be inappropriate, indicating a desire to provide a "Supervisory Board" comprising non-executives to monitor an "Executive Board". In the event that such a complex board structure was in place, and that a difficulty arose, would all directors be regarded as responsible and accountable; or would the executive board members be primarily responsible; or would the non-executive directors effectively acting as monitors be even more accountable? In the event that responsibility is shared by all directors, then the divide between executives and non-executives would be more apparent than real.

**2. THE BOARD (continued)**

**2.4 Non-executive directors (continued)**

- We believe that there are only a limited number of high calibre non-executive directors and, as a consequence, insufficient in number to fill the posts likely to be available should the Committee's proposals on non-executive directors be accepted. In the event the intention is to involve directors who are executive directors in one company as non-executive in another, then we do not believe the requirements as to the amount of time which they will have available to perform their duties, their ability to discharge their duties free of any business or financial connection; and be wholly independent (paragraphs 4.9 and 4.10), will be met. It is possible, therefore, that a small group of non-executive directors would hold these positions, giving rise to concern over their ability to avoid conflicts of interest and not be subjected to pressure to assist those known to them. We are aware this issue has been previously considered at other conferences, including the CBI Conference last month.
- We support the view that non-executive directors should be entitled to take independent professional advice, if necessary, at the company's expense. We also believe, however, that the same principle should apply to all directors. (Paragraph 4.12)
- We also support the proposals relating to a limited term for non-executive directors' appointments. In the event that such term is, say, three years, we believe that the same period should apply to executive directors. As a consequence, retirement and re-election considerations would only arise at the expiration of those terms, unless some event requires an earlier change. (Paragraph 4.14)
- We believe that all directors should be nominated by the board as a whole and, therefore, do not support the view that Nomination Committees should exist for that purpose. (Paragraphs 4.13 and 4.24)

**2. THE BOARD (continued)**

**2.5 Executive Directors**

- We support the proposals in relation to directors' emoluments disclosure (paragraph 4.32) and directors' service contracts (paragraph 4.33). There appears to be inconsistency as between what is required for directors and executive directors and this needs to be re-examined (see Code 3.2 and paragraph 4.32).
- We do not believe that the appointment of Remuneration Committees should be mandatory. The need for such committees should be reviewed by each company. We accept that it is likely most major companies would wish to establish such committees and that should be their right to do so. It should not, however, automatically apply to all other companies. (Paragraph 4.3)

**2.6 Directors' Training**

- We believe that insufficient consideration has been given to the need for proper and effective training of directors to enable them to fulfil their responsibilities and duties properly. It is essential that directors have not only relevant skills, but also fully understand the responsibilities of stewardship and governance. We believe the Committee should give more detailed thought and proposals in this regard, including the possible need for a directors' training school.
- We accept that newly appointed directors can attend courses run by the Institute of Directors and business schools, but attendance is at the option of individual directors and/or companies. We believe that some mandatory attendance, and success, at some specialist educational establishment should be the basis on which individuals are allowed to act as directors.



**3. INTERNAL CONTROLS AND REPORTING**

**3.1 Audit Committees**

- We do not believe that the establishment of Audit Committees should be a mandatory requirement. Because of our reservations over the ability to ensure that non-executive directors will be truly independent and have sufficient time to devote to such a role, we also question whether such committees are able to exist in all companies. We accept that such committees may be appropriate to some companies, but do not believe they should be imposed on all, irrespective of size, nature of business and complexity.
- Directors as a whole should have responsibility for issues covering the appointment of auditors, review of the internal audit functions and consideration of reports from both internal and external auditors. Furthermore, we believe that the finance director and possibly the Chief Executive should be involved in consideration of such matters.
- The responsibility for dealing with financial matters at an Annual General Meeting of the company should, in our view, fall on either the Chairman or the finance director. We do not believe the involvement of a Supervisory director from an audit committee reporting on such matters is appropriate.

**3.2 Internal Controls**

- We agree with the proposals in relation to internal controls and the need for a statement by directors in their Report. In order to ensure some uniformity in approach on this matter, however, we believe some guidance should be given to directors.
- We accept that auditors should also make some statement on such controls and we will be making comments on this aspect to the Accounting Standards Board and Auditing Practices Board as appropriate.

**3. INTERNAL CONTROLS AND REPORTING (continued)**

**3.3 Financial Reports and Reporting Practice**

- We support the view that it is the board's duty to present a balanced and understandable assessment of their company's position. Some further guidance on what is required in this context should be provided to directors. We are aware of the Accounting Standards Board's discussion paper "Operating and Financial Review" and agree with its proposals (paragraphs 4.41 to 4.49). It would be appropriate, in our view, for some other guidelines to be given to directors to enable them to ensure they comply in all respects.
- We also support the view that half yearly interim reports should include balance sheets and that such interim reports should be reviewed by Auditors. It is essential that guidance is given on the review to be undertaken and Auditors' obligations in relation to such reports so as to minimise cost and avoid any widening of the 'expectation gap'. We are aware of further discussion papers being issued to assist in this process. (Paragraph 4.47)
- We agree with the suggestion that directors should explain their responsibility for preparing the accounts next to a statement by the Auditors about their reporting responsibilities. (Paragraph 4.22)

**4. AUDITING**

**4.1 Separation of Audit from Other Services**

- We agree with the requirement that auditors should ensure the objectivity and effectiveness of their work. We do not accept, however, that this is only possible with the existence of an Audit Committee.

**4. AUDITING (continued)**

**4.1 Separation of Audit from Other Services (continued)**

- We were disappointed that the Committee did not take this opportunity to review the role and work of Auditors and put forward proposals for consideration by the Accounting Standards Board and Auditing Practices Board. In our view, this was an issue which should have been addressed at this time, particularly in the context of the Caparo case.
- We do not believe there should be any restriction on Auditors' ability to carry out non-audit services for their clients. (Paragraph 5.10)

**4.2 Responsibilities of Auditors**

- We agree with the proposals relating to Auditors' reports and the need to state clearly Auditors' responsibilities for reporting on financial statements. (Paragraph 5.14)

**4.3 Rotation of Auditors**

We do not agree with the mandatory rotation of audit firms. We do not believe that a company's best interests are served by such rotation. We believe a more satisfactory alternative would be the regular rotation of audit partners and managers. This should be a matter for the audit firm and not be prescribed.

**4.4 Going Concern**

We agree with the proposals contained in the draft Report. These matters are being progressed through the Auditing Practices Board and the Accounting Standards Board, to which this firm has made its submissions.

**5. SHAREHOLDERS**

- 5.1 We were disappointed at the lack of consideration of the requirements of users of accounts and the extent to which they could exercise greater and more significant influence over companies' affairs.
- 5.2 We would urge the Committee to consider further the role of shareholders and, in particular, institutional shareholders, and their ability to influence the standards of corporate governance. We recognise this is being addressed within the statement published by the Institutional Shareholders Committee, but believe the Cadbury Committee could embrace the issues in paragraph 6.8 with greater effect.