CAB-02477

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Nigel Peace Esq
Secretary
Committee on the Financial
Aspects of Corporate Governance
PO Box 433
Moorgate Place
LONDON
EC2P 2BJ

Your ref

Our ref

25 August 1992

Dear Mr Peace

I am enclosing a note arising from a discussion meeting held in this office between a group of senior non-executives directors in Scotland and some KPMG partners.

I regret that it was not possible to submit this note prior to 31 July but nevertheless hope that the comments might be of assistance.

Yours sincerely

DM Nicolson
Partner

dmn/fcl/lett

The Cadbury Committee report on the financial aspects of corporate governance

Note of a discussion held at Saltire Court, Edinburgh on 13 August 1992 attended by:

Non executive directors

Professor Ewan Brown MA LLB CA
Professor Robert B Jack CBE MA LLB
Mr Nicholas CD Kuenssberg BA FCIS CBIM
Mr Nicolas McAndrew CA
Sir Lewis Robertson CBE FRSE
Mr Barry E Scaley CBE BA MInstR
Professor Jack C Shaw CBE BL FRSE CA FCMA MBCS JDipMA
Mr Charles F Sleigh CA
Mr C Murray Stuart MA LLB CA FCT FRSA

KPMG Peat Marwick Partners

Mr DT Boyd CA
Mr W Drysdale CA
Mr CGA Fletcher BA CA
Mr AS Hunter CA
Mr SH Ingall MA FCA
Mr DM Nicolson CA

The object of the discussion was to give participants an opportunity to hear and express views on this important matter. A note of the discussion would be compiled and, if agreed by those attending, would be submitted to the Cadbury Committee.

The principal conclusions of the discussion were as follows:

Responsibilities of directors

The group considered that the draft report implied unnecessary division in board responsibilities as between executive and non-executive directors. The distinction in the roles was generally accepted, particularly for example, as concerns the non-executive composition of the audit and remuneration committees, but the group believes that the report ought to emphasise the shared responsibility of all directors for the affairs of a company.

There was significant support for a proposal that the annual review of operations and prospects, whether contained in the chairman's review, executive summary or directors' report, should be issued with the approval of all the directors. There should be emphasis that all directors are responsible for the contents of the annual financial statements.

Statement on going concern

The group saw difficulty in reconciling the proposal in the draft going concern auditing standard that directors should look ahead for a period of at least twelve months with the comment in the Cadbury draft report (para 5.20) that a shorter period may be further ahead than many companies can see, for example, in a recession.

In those companies which cannot reasonably see ahead for a period of twelve months it is assumed that this uncertainty will be reflected in the financial statements and the report of the auditors; while such references in financial statements may become acceptable over a period of time, concern was expressed by the group on the difficulties which could occur - with media reporting or in relationship with auditors - in a transitionary period.

The group believes that responsible statements as to the going concern assumption are fundamental to fair financial reporting and agrees that such statements should cover a period of at least twelve months from the date of the financial statements. The group understands the co-operation that would be required with bankers in meeting these reporting obligations and believes that satisfactory working practices ought to be capable of being developed.

Responsibilities of shareholders

The group welcomed the proposals of the draft report concerning the function of the nominations committee but agreed that a key element in monitoring the affairs of companies was the responsibility with which institutions viewed their role as members.

The group felt that it was neither reasonable to suggest that all institutional investors were inactive in this sense, nor that they had unrestricted time and resource to devote to these responsibilities. The consensus conclusion was that Cadbury should:

- emphasise the need for responsible institutional investor behaviour;
- recommend monitoring of and reporting on the extent to which the statement of the Institutional Shareholders Committee is followed.

Auditors

The group did not feel that it was inconsistent for auditors to take both a pro-active stance in advice to clients and a strong independent line in discharge of the audit function, but felt that failure now to do either with commitment would be extremely damaging to the auditing profession.

The group acknowledged that, recently, the standing of the audit report had been under attack. The principal needs now were:-

- better public understanding of the audit objectives and scope;
- improved auditing standards;
- firmer discipline.

The group acknowledged that steps were now being taken to address these issues but felt it important that the Cadbury report should emphasise that, in the context of corporate governance, it was essential that the auditing profession did everything in its power to re-establish the reputation of the auditor and the audit report.

The Cadbury Committee Report on the financial aspects of corporate governance

Internal control

The group believed that executive director fraud was an important but not an overriding concern. It was felt that many more companies had failed due to excessive risks being run without sufficient resources to back them than had failed through fraud or illicit behaviour.

Consideration was given to whether it was possible to control the dominant chief executive all the time, and generally thought that it was not. It was, however, appropriate to set up mechanisms which might limit the extent of any damage, or enable boards to identify problems at an early stage.

The group felt that the Cadbury report should emphasise that proper systems of internal control, which should include assessments of how boards identify and control business risks that companies are running, as well as how they control risk of loss through malpractice or negligence, should be put in place by directors.