

Sir Adrian

I will acknowledge if you prefer,
but would you rather do a hand-
written acknowledgement of your
own?

NJM.

17/6

From Neville C Bain
Group Chief Executive



15 June 1992

Mr Nigel Peace
Secretary
Committee on Financial Aspects
of Corporate Governance
P.O. Box 433
Moorgate Place
London EC2P 2BJ

Coats Viyella Plc
28 Savile Row
London W1X 2DD
Telephone 071-734 4030
Telex 21232
Facsimile 071-437 2016

Dear Mr Peace

May I first of all say how heartened I am with the progress made by the Cadbury Committee and that I am very supportive of the recommendations and The Code of Best Practice. The points that I make in this brief submission should therefore be viewed within this context.

Guiding Principles

1. Corporate Governance is about commitment rather than compliance which is why I fully support a code of best practice instead of a plethora of new accounting and other rules or statutes.
2. The debate which the Cadbury Committee has greatly enhanced must result in the raising of board standards closer to best practice.
3. It is essential to provide, as your report does, for the ongoing review of both what constitutes best practice and what progress in general is being made towards this.

Audit Committee and Role of the Auditors

I fully endorse the requirement of a fully functioning audit committee constituted in the way described in your report. We should not wait two years for this and, from practical experience, I know it can be implemented in less than one year.

In my view, the audit committee is more effective where an internal function exists and the head of internal audit, as well as the external auditors, attend. The audit committee can then review the internal audit programme and key findings on a regular basis.

I do not agree that by having one occasion each year for the external auditors to meet solely with non-executives we create division or "them and us". This is a necessary part of the checks and balances.

Composition and Effectiveness of the Board

1. I believe that The Code of Best Practice should require a split of the role of chairman from that of chief executive. There is a broad consensus that this is beneficial on the following grounds:

- a) The balance of power and the need to avoid the effects of the "runaway train".
- b) There are in fact two distinct roles which if not separated should require the individual to physically wear two different hats - perhaps black for chairman or green for chief executive!!
- c) Detachment is enhanced by separation.
- d) Succession planning is enhanced by separation.

Personally, I do not find it as credible to have a "leader" of non-executives to try and provide the balance. As for the argument that there are a few occasions in a company's history whereby it is helpful to have single strong leadership, then this step could be taken and a note in the accounts given for the non-compliance of "best practice" and the expected time this will apply to. Just as a corollary the "strong leadership" argument is usually overdone and may well take the company in a very wrong direction.

I would allow only two years for companies to comply with this best practice.

2. The value of non-executive contributions to the Board is influenced by a number of factors, including the leadership and style of the chairman, the climate in the boardroom and the composition of the board. I endorse the imperative of professional recruitment and choice for non-executives and reject patronage which remains rife even today. In addition, the composition of the board is really important.

In my view, there needs to be some statement of best practice, perhaps suggesting a minimum of three non-executive directors to provide balance both of skill base and experience and to ensure balance with executive directors. You may prefer not less than one third non-executive and never less than two.

3. The chairman should be encouraged to formally appraise the role of the board annually and make the time to talk to each director about that perspective of the Board's effectiveness.

4. There has been some debate about creating a split of directors, according to executive or non-executive roles, when all are legally directors. I do not share this view as the competent chairman can, with skill, ensure team working, openness and effective functioning. There will always be some trade off with the need to provide checks and balances and the additional small burden on the chairman. To achieve the balance is a preferable solution to not exercising independence of non-executives or monitoring the executive management.

Controls and Reporting

In general, companies will need to provide more attention both to the quality and quantity of reporting to ensure full communication with the city. The annual report and interim report are the two set pieces for the Board to communicate with shareholders and the board can grasp this opportunity to provide concise relevant information. I have already commented on suggestions in my paper "Physician, Heal Thyself". The chairman also has the responsibility to ensure that a formal programme of investor relations activities is in place and that institutions are satisfied with the programme.

1. I welcome the additional information to be provided at the half year with the interim results, especially the balance sheet and the auditor's review. I am disappointed that you have not called for immediate publication of a cash flow statement as an essential part of this.
2. I understand the suggested codes focus on director's responsibility for preparing the accounts. If this becomes too formalistic, and indeed annually repetitive, it will lose real value. I also think that the "going concern" concept (para 5.18) is important but I do not want to see heavy guidelines with auditors making a meal of this new pasture for fee generation! My preferred alternative is to require the audit committee to report to shareholders on the scope of its work, the extent that they have reviewed the accounts and that they are satisfied with their integrity and that all relevant information has, to the best of their knowledge and belief, been properly disclosed. I would certainly expect the audit committee to discuss the key aspects of the accounts with the finance director, chief executive and auditors before coming to this opinion.
3. I welcome the recommendations on disclosure of the remuneration of the board, especially including sufficient information to understand the basis of calculation of performance related pay. As a matter of interest, contributions to pension funds have not been commented on in your report, yet I know that "deferred compensation" can be a major factor. I am aware of specific examples where the contribution paid by the company for pension contributions of directors or a particular director varies from 12% of total remuneration to 105% of salary! In most cases it varies from 35% to 75%.

General

While I am mindful of the Committee's terms of reference, in public mind there are areas where your comment would be welcomed and perhaps where guidelines could be suggested.

1. Pensions Governance.

Clearly, current events make this topical and the Committee should consider comment of best practice or future steps to be taken. Perhaps this should cover:-

- Overt independence from the company with independent trustees and an independent chairman.

- An embargo on dealing in the company shares.
- Independent management which is monitored and assessed by the trustees.
- A requirement by the company that the annual pension audit and management letter is discussed with the company audit committee. The reason for this is to underline the point that the company needs to exercise good governance to other stakeholders.

2. Auditors

The only additional comment I have to your para 5.11 is that while the separation of fees paid to accountants who act as auditors and also in other areas is applauded, I deplore the assumption in the public's mind that fees paid for non-audit work compromise objectivity. The accounting firm that audits is well placed to provide such services cost effectively and typically would, on a large piece of work, need to be competitive in quote. While auditor bashing is a popular sport of the masses it is overdone.

Thank you for the excellent work to date and for the opportunity of making submissions on your draft report. Please also pass on my best wishes to Sir Adrian.

Yours sincerely



Neville C Bain

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