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Sir Adrian

COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

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20th September, 1991

J. A. B. Joll, Esq.,
Finance Director,
Pearson, plc,
Millbank Tower,
Millbank,
LONDON, SW1P 4QZ.

Dear Mr Joll,

Thank you for seeing Sir Adrian and me yesterday. It was an interesting and lively discussion.

We promised to let you have details of the monthly publication 'Company Reporting'. I attach a copy of a sales leaflet which was sent to us by Mark Layton of the publishing company, Incomes Data Services Ltd., 193, St. John Street, London, EC1V 4LS (071-250 3434). Mark Layton indicated to us that he would be happy to supply sample copies.

Yours sincerely,

Nigel Peace

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Secretary

RECORD OF MEETING WITH MR JAMES JOLL, FINANCE DIRECTOR OF PEARSON PLC, ON 19 SEPTEMBER 1991

<u>Present:</u>

James Joll, Finance Director
Anthony del Tufo, Group Financial Controller
Sir Adrian Cadbury
Nigel Peace

Mr Joll said that it would be very helpful if the financial and institutional community recognised that companies grew in fits and starts. Companies faced great pressure to show seemless growth, and this led to temptation to massage the published results. Most creative accounters recognised that they could not fool the world forever but they did want to present a record of steady growth.

2 Mr Joll continued that the auditor of a rough company that wanted to show growth theoretically had three courts of appeal if he was under pressure to knuckle under:

- <u>the Audit Committee</u>. A good company would have a non-executive Audit Committee of substance and integrity that was interested and concerned about the audit and provided the opportunity for the auditor to speak in confidence about any concerns. (He as Finance Director found the Committee helpful to him in reinforcing the financial control function, and he also found it helpful for the Chairman of the Audit Committee to be generally around and accessible.) The obvious weakness was that a rough company would have either no Audit Committee, or one that was weak or did not function properly. Audit Committees could be made mandatory, but legislation could not make them effective.

- <u>the institutional shareholders</u>. The problem, sadly, was that in practice they took no interest in the adequacy of accounts. It would help if shareholders were to put pressure on companies to improve disclosure and transparency. Many reports were lamentable but nobody cared. (Sir Adrian commented that he saw the beginnings of some external analysis, such as the Philips and Drew report and the new monthly publication 'Company Reporting'. His Committee might usefully look to help the pressure build.)

- the Financial Reporting Review Panel. This was a long-stop however, to catch real abuses, not practices that were just 'a bit iffy'.

3 Referring to relations with the auditors in his own company, Mr Joll said that management certainly had views about certain transactions and how they should be treated, and inevitably judgements were involved. The company kept a 'register of large and unusual transactions', and a major meeting was held with the auditors each October to discuss it. The object was to put the auditors on notice and to avoid them feeling that they were being bounced at the last minute. The company preferred to agree by negotiation with the auditors what controversial issues should be put to the Audit Committee. A meeting was also held with the auditors in October to review accounting policies.

4 Mr Joll said that one recent issue with the company's auditors had been the provision made in the 1990 accounts against the investment in BSB. The auditors had made it clear that they would find it difficult to approve the accounts if provision was not made. They had not however said that it would be impossible for them to be convinced. He regarded this as the right approach. Companies needed intelligent auditors who were prepared to argue matters through. This was likely to lead to better solutions.

5 Mr Joll continued that he did not support compulsory audit rotation. The number of big firms was limited: there would be 6-crop cycle but no collective loss of business. Furthermore there was a great deal of work involved in going to tender. It would just not be impractical to put the best bids to the shareholders for selection. Pearson was happy with its auditors: it regarded them as both professional (with clear standards about what they regarded as correct) and commercial, in the right sense. It had recently secured a reduction in the audit fee (£1.7m) but had made clear that it wanted to retain the existing firm.

6 Mr Joll said there was more to be gained by making internal audit effective within the company. Pearson had spent heavily in this area. Internal auditors dug out all sorts of things - not resulting from corruption, but unquestionning acceptance of the way things were done. It was critical that the head of internal audit should have access to the Audit Committee.

7 Mr Joll and Mr del Tufo spoke favourably about the work of Professor Tweedie and the ASB. They commented however that the ASB's proposals on cash flow were not yet absolutely right. Generally they said that many problems would be solved if companies were obliged to provide a decent written explanation of the figures in the accounts. The accountants were still concentrating on the numbers; but good reporting internally depended on the words and the same principle should extent to external reporting. Inflation accounting had died because of the focus on the figures: these were boring, tucked away at the back, and forgotten. If there had simply been an obligation on boards 'to explain the impact of inflation on the company's accounts' then something might have happened. The 10k approach in the US was worth looking at. They added that information about the future would always be cautious, and that it was better to have good information about the past than carefully headged information about the future. A requirement for the auditor to say more in his report than confirm that the accounts showed a true and fair view would probably only lead to bland comment, although it could be argued in the case of Polly Peck for example that a longer statement by the auditors might have drawn attention to the cash flow problem.

8 Mr Joll and Mr del Tufo suggested that there might be merit in requiring companies to list all the audit firms used by the group; and to disclose all the fees for non-audit services paid to these firms. It was not for instance clear from Pearson's accounts who audited the US subsidiaries. This would provide the shareholders with more information but it would be inconsistent in requiring disclosure of consultancy fees for non-audit services paid to some firms but not others.

NDP

20 September 1991