

## ALLIANCE ■■■ LEICESTER

N. Peace Esq.  
Secretary  
Committee on the Financial Aspects  
of Corporate Governance  
PO Box 433  
Moorgate Place  
London EC2P 2BJ

Date: 3 August 1992

Your ref: -

Our ref: LAW/RV/GSM

Dear Sir

CADBURY REPORT - THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE

I refer to the above Report which has received careful consideration within the Society. The Report has generally been welcomed and the principles of the draft Code of Best Practice are judged to be acceptable in most respects.

It is noted that the Code is at this stage primarily intended for adoption by listed companies, although most of the recommendations reflect practices which are either already in place in building societies or which would be unobjectionable if at some future stage it was thought right to adopt them.

Our Society, in common with other building societies, already has a majority of board members who are non-executive, already operates an audit committee and has a sound framework for internal audit. Building societies are subject to a close degree of statutory supervision, and this has created high standards of financial reporting, upon which the accountability envisaged in the draft Report must mainly rest.

Against this background, I have the following comments to make with reference to particular paragraphs of the draft Code:

1. Paragraph 4.2. Directors' Report on Systems of Internal Financial Control.

Whilst recognising the difficulty about accommodating a special position for building societies (and banks) I wonder whether the Committee has considered the effect on deposit taking institutions where there is a fundamental dependence on customer confidence?

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APPOINTED REPRESENTATIVE OF THE SCOTTISH AMICABLE MARKETING GROUP, MEMBERS OF WHICH ARE MEMBERS OF LAUTRO AND IMRO.  
ONLY IN RELATION TO SCOTTISH AMICABLE LIFE ASSURANCE, PENSION AND INVESTMENT CONTRACTS.

IMRO

There could be a serious risk that any reference in the Accounts to the effectiveness of controls, including any comments by the auditors on such a report, could be misinterpreted and have serious consequences.

These comments need to be seen in the context of the very high degree of regulation in the case of building societies. The Society's system of internal financial control is subject to examination by external auditors under the Building Societies Act, and reports are sent to the Building Societies Commission.

2. Paragraph 4.6. Directors' Statement - Going Concern.

Similar considerations apply where this recommendation is concerned. Any reference by directors or auditors as to whether or not the Society is a going concern could prompt a massive and damaging reaction by investors. It would be easy for an ill-judged statement, perhaps originated by over zealous auditors to become a self-fulfilling prophecy.

Further comments on the draft Report generally:

3. Auditors

An explicit reference in the Report to auditors' responsibility to make contact with the auditors of other Group companies or connected companies might not go amiss. A lack of such communication was a feature of the Maxwell affair.

As to auditors' liability and the "expectation gap", I have the impression that the report concentrates too much on emphasising the enhanced duties and responsibilities of non-executive directors in relation to the financial statements whilst seeking to limit the responsibilities of the auditing profession. Clearly there is a balance to be drawn but I think it is being shifted too much to the detriment of non-executive directors and to the relief of auditors.

4. Annual General Meetings

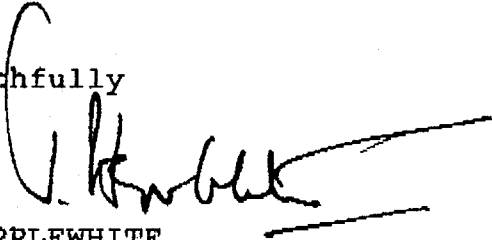
There is an argument that the submission of members' questions prior to the AGM could lead to a less effective form of scrutiny since it would allow carefully crafted answers to be prepared. With over two million members the Society's practice has been not to inhibit the method of submitting members questions but to accept them verbally or in written form.

In the case of the suggestion that the chairman of the audit committee should deal with questions, it needs to be emphasised that such questions should relate to the role of the audit committee within the organisation.

5. Pension Governance

The important area of pensions could usefully be given greater prominence. In particular, more guidance could be given on how the separation and safeguarding of assets is to be achieved.

Yours faithfully

A handwritten signature in dark ink, appearing to read 'J. Hepplewhite', with a long horizontal stroke extending to the right.

JULIAN HEPPLEWHITE  
SECRETARY AND CHIEF SOLICITOR