

COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

CAD-02439

5th August, 1992

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Brian Thompson, Esq.,
UK President,
The Institute of Chartered
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16, Park Crescent,
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Dear Mr. Thompson,

I am writing on Sir Adrian Cadbury's behalf to acknowledge your letter of 3rd August, and to confirm that your comments will be taken into account before the Committee's report is finalised.

Yours sincerely,



Pat Snoad
Secretary to Sir Adrian Cadbury

ICSA

THE INSTITUTE OF
CHARTERED SECRETARIES & ADMINISTRATORS

Patron Her Majesty The Queen



Sir Adrian Cadbury
Chairman of the Committee on the Financial
Aspects of Corporate Governance
PO Box 433
Moorgate Place
London EC2P 2BJ

3rd August 1992

Dear Sir Adrian,

General Comments on the Draft Report on Corporate Governance

We welcome the opportunity to comment on the proposals of your Committee which we believe will make a positive contribution to the improvement of standards of corporate governance. We have already submitted our comments on the role of the company secretary and would now like to comment on a number of the more general aspects of your Committee's report.

The overriding purpose of the Committee's Code of Best Practice should be to establish a generally accepted standard against which shareholders and potential investors are able to assess companies' systems of governance. The provision of information is, therefore, key to the success or failure of the Committee's proposals.

Enforcement

Although the Committee's code should not be prescriptive, the requirement to disclose information should be more rigidly enforced. Shareholders will not be able to judge whether remedial action should be taken if they do not know what standard the company achieves. The emphasis of the Code should be on ensuring that the company provides sufficient information to enable shareholders and potential investors to judge for themselves.

More positive drafting

To this end, we would urge the Committee to be more positive in its drafting of the Code of Best Practice. There does not seem to be any reason why the wording should not be more forthright if it is not intended to be prescriptive and there are no formal sanctions for those who fail to comply.

It should be made clear that universal compliance with the code is not expected, particularly for smaller companies, and that it is up to shareholders to deal with non-compliance. The code should be drafted to ensure that as much information as possible is disclosed and that companies explain any departure from the norm.

For example, on a strict interpretation, companies with a combined chairman and chief executive would comply with article 1.2 if they had appointed a leader of the independent element on the board. It is inconceivable that such a company would be foolish enough not to appoint a leader and it would require a brave auditor to declare that this independent element was not strong. The overriding principle of best practice in article 1.2 is the separation of the roles of chairman and chief executive. The inclusion of 'second best practice' in this article reduces its impact. 'Second best practices' should be included in the body of report and not in the Code of Best Practice. Companies which combine the posts of chairman and chief executive should be capable of explaining why they have chosen to do so.

Notwithstanding the fact that the views of the non-executives should be heard in the boardroom, it is essential that the board should act as a team. All directors owe a duty of care to the shareholders and are therefore accountable for the actions of the board.

Auditors' review of the statement of compliance

It is unquestionably appropriate that the auditors should review matters such as directors' service contracts which exceed three years, directors' emoluments, the effectiveness of the company's systems of internal financial control, and the directors' statement that the business is a going concern. However, we have a number of reservations regarding the suitability of the auditors to review some of the other requirements of the Code.

For example, one of the requirements of the Code is that there should be a 'professional relationship' between the company and its auditors. This would seem to place the auditors in a potentially awkward situation and we doubt whether they should be asked to review this matter.

Words which are difficult to interpret definitively have been used in other parts of the code which would cause problems for anyone reviewing the statement of compliance. The clearest example is article 1.3 on the number and calibre of non-executives. It is arguable that one strong-minded non-executive could carry significant weight and, consequently, that a company with only one non-executive could claim that it complies with the code. In these circumstances, it would seem that the auditors could do nothing more than alert the shareholders to the numerical inconsistency. They are unlikely to be willing to make an adverse statement on the calibre of that non-executive. In such circumstances, their review will not be of much benefit to the shareholders. The Code would be deficient without the word "calibre" but its qualitative nature makes quantitative analysis by auditors superfluous.

In our view it would be unfair to expect auditors to do anything other than review the factual accuracy of statements of compliance. Wherever possible, it should be left to the shareholders to judge whether the company has complied with the code on the facts provided. Yet again therefore, we feel it appropriate to stress the importance of ensuring that the shareholders are given sufficient information to form a judgment on these matters. The auditors' role should be to verify the information provided, not to make qualitative judgments on behalf of the shareholders. To take this to its logical conclusion, we think there might be a role for a shareholders committee and we believe that companies and shareholders should be encouraged to be innovative in this regard.

Group subsidiaries

We think it would be worth emphasising in the final report that some of the basic principles of the Code are equally applicable to major operating subsidiaries of public listed companies, particularly where the listed company is essentially a holding company.

Boardroom procedures

We would like to re-emphasise the importance of establishing written procedures for the conduct of the board's business. Unwritten procedures are no longer acceptable in the modern business environment and all boards should seek to establish a framework within which to operate and manage the company. These procedures should include, inter alia, a the list of the matters reserved for the decision of the full board, the terms of reference of committees of the board, rights of access to information for directors (and the secretary), the frequency of meetings of the board and its committees, and the duties and powers of the company secretary.

These procedures should be reviewed and amended on a regular basis. Provision should also be made to deal with exceptional circumstances which can often arise. These procedures should be geared towards the promotion of collective board responsibility.

We are currently working on a guide to the matters which should be included in board's written procedures which we hope to complete by September 1992.

Rotation of directors

We strongly believe that all directors of public companies should be subject to re-election by shareholders at least once every three years. The exclusion from rotation of directors who have a service contract with the company should not be regarded as acceptable practice.

Looking to the future

Although it has already been proposed that a review be conducted two years hence, it would seem to be appropriate to give some further thought to the future as it seems certain that the generally accepted standards of the future will be different from those of today. Our understanding of corporate governance is likely to be improved and changed following the introduction of the code. The ability of shareholders to monitor and influence standards of behaviour will be enhanced and the attitudes of the various participants may change.

If companies are to be required to report on compliance with the code, it is essential that it should continue to reflect generally accepted standards. The credibility of the voluntary code will soon be undermined if it is not capable of being adapted to meet the problems of the future. We believe therefore that a more permanent review body will need to be established to set the standards for the future.

Yours sincerely,



PP Brian Thompson
UK President