

The twenty-third day of January 1991, may turn out to be as significant a date for financial reporting as the twenty-fifth day of January is for the followers of Robert Burns, since it was on that date that David Tweedie commenced his revolution of financial reporting, building on his views, shared by the Research Committee of The Institute of Chartered Accountants of Scotland (ICAS), that present financial reporting methods require a rethink to ensure that in future financial reports of companies are not only true and fair but also informative. At long last, it is likely, through the work of the Accounting Standards Board, the power of the Review Panel and the support of legislation in the form of the Companies Act 1989, that investors and users of accounts in this country and overseas will have a practical and conceptually based method of financial reporting.

The creation of new standards of financial reporting, however, is only one strand of the development necessary to make corporate governance in this country more effective. The others are the effectiveness of boards of directors, the integrity of financial information and the responsibilities and standards of auditors. Confidence in corporate governance of companies, in particular public listed companies, is essential for the health of the market economy. The dramatic corporate failures of recent months raise questions on the governance issue. The opportunity of these times is to improve matters for the future with the caveat that any legislation does not restrict business from creating wealth. Peter Morgan, Director General of the Institute of Directors, defines the objectives of good corporate governance as being "...to ensure that a company survives and thrives and that it conducts its affairs with ethics and integrity." My thoughts on the subject over the last few years lead me to the following suggestions:-

Boards of Directors

Independent, non-executive directors should be appointed to all public listed companies. Although not involved in the day-to-day running of the company, they have a valuable and objective role to play in assessing a company's performance. They can review constructively the effectiveness of management, provide a forum to appoint auditors and ensure that the necessary steps are taken to meet the concerns of auditors, particularly those relating to the integrity of accounting information, irregularities, going concern issues and the disclosure of information in accordance with accounting standards. They are a necessary part of the unitary board of the future. Guidance should be developed to define the role of such directors, the process of appointment and the necessary attributes.

Integrity of Financial Information

Any receiver will tell you that a common fault of ailing businesses is the absence of quality information. Irregularities and fraud often follow from poor systems of accounting and internal control and weak boards of directors. The investor depends upon the integrity of information about a company's asset position, results and cash flow throughout the year not just at the year end. The present legal requirements for proper books of account are inadequate for public companies. It is suggested that all public companies should be required to maintain adequate management information systems and internal control, that the directors collectively as a board should be satisfied with these and that this should be reported to shareholders.

There are already precedents in respect of banks, building societies and companies registered under the Financial Services Act regime. Should these not apply across the rest of the public and private sectors for public listed companies?

The Stock Exchange and the Auditing Practices Board should review the guidance given for interim financial statements with a view to setting standards and requiring the auditor to review these so that users are informed more frequently.

Responsibility and Standards of Auditors

As from Spring 1991, the practice of auditing will be monitored by the Recognised Supervisory Bodies under the Companies Act 1989. The new Auditing Practices Board will commence work in April 1991 and will re-examine the auditing standards and guidelines necessary for the rest of this century and beyond. Its members will include a significant number of businessmen of standing and representatives from the public sector auditing world. It is suggested that now is the time to carry out research into the public's expectation of auditors and define what can reasonably be expected of them.

Flowing from this we need to re-emphasise the auditor's responsibility in relation to the detection and reporting of fraud and irregularities and re-consider the guidance given in the light of the research. In this connection, non-executive directors are important potential recipients of information from auditors about their suspicions because they have the power to take action on such information. Also important is the relationship which auditors should have in significant cases with regulatory bodies and the DTI.

The three Institutes of Chartered Accountants in the UK and Ireland have a general concern to address matters of importance to the profession. In recognition of the need to make corporate governance more effective, ICAS is setting up a working party to research and develop further the issue of corporate governance as seen from the point of view of auditors and our members in business. This initiative, to be led by Nigel Macdonald, is a logical follow-up to previous initiatives such as our Company Law Strategy Unit's work on the development of company law and the Research Committee's invaluable contribution to the development of financial reporting, "Making Corporate Reports Valuable". I expect the work of our new group and its report "Making Corporate Governance More Effective" to be of equal importance in this area.

Sent by J.P. PERCY TO ACCOUNTANCY AGE

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