



the department for Enterprise

CAO-01097

Mr Nigel Pearce
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 Committee on The Financial Aspects of
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Dear Nigel,

As I think you know, I shall not be able to attend the Committee's meeting on 11 September as I shall be on holiday. If you should want a substitute, perhaps you would have a word with Callum Johnston (215 3199). He is also the person to speak to if there are any points you want to discuss arising out of the papers for this meeting.

Thank you for taking account of most of my earlier comments on the draft work programme and framework for the Committee's report. I still think that there are structural problems with the latter. This is largely due to the Committee's wish to consider some issues about the constitution of company boards and the role of major shareholders which go rather wider than strictly "financial aspects". It may be that the structure of the report will need to be reviewed once the Committee has decided how far it wants to go into these issues. The important point for now is to ensure that the key issues have been identified. We have not spotted any omissions. When you do review the structure, one possibility might be to bring together in one place all the material about board composition, audit and remuneration committees etc, including the role of shareholders in insisting on such arrangements. This might logically come at the end of the report once it has discussed financial systems, financial reporting, role of auditors and communications with shareholders. The report could then conclude by saying that to carry out all these responsibilities well, the board itself needed to be properly constituted. Alternatively this could come at the beginning. What I do find awkward is mixing detailed material on statutory reporting etc with material on non-executive





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directors. I also still find it odd to have the chapter on audit after the chapter on shareholders given the importance of audit for shareholders.

I have only had time to glance through the other papers for the meeting. Three points struck me:

- (i) It would be a major task to define the responsibilities of either non-executive directors or directors generally. It would involve far more than trying to identify areas in which non-executive directors can make a special contribution, given that their responsibilities are legally the same as those of executive directors. It would be necessary to consider the whole range of legislation which puts duties either on directors or on companies for which the directors could be held responsible. Those who have tried in the past to produce a complete list have given up the attempt as being too difficult. I am sure that it is not something the Committee should take on.
- (ii) You already know the Government's view on legislating to require the appointment of non-executive directors. Briefly it is that non-executives are only useful if they are well informed and independent minded and these are not qualities for which you can legislate.
- (iii) On directors' remuneration, I am sure the Committee should be cautious about how far it goes but it might want to comment on what kind of measures are appropriate for determining performance pay (or more probably what kind are not). If the wrong kinds of measure are used, it can create a conflict between the interests of directors as individuals and the long term interests of shareholders. For example, if the measure is earnings/share, there may be a temptation for directors to take a short term approach or to adopt a misleading accounting presentation, in order to boost earnings. Especially given the potential link with financial reporting, the Committee might at least want to debate this point.

I have asked Callum Johnston to let you have any further comments arising from a more careful reading of the papers.

Your sincerely
Sarah C. Brown.

MRS S E BROWN