

CAD-01139

COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

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14th January, 1992

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Dear Mike,

Many thanks for your letter which I received just before Christmas and my apologies for being so long in responding. I appreciate your comments on the paper, which was very much a first shot at pulling together points raised in our discussions, rather than a considered draft. Nevertheless, I am most encouraged that you felt we were basically on the right lines.

I go along with your suggestions on wording and I am sure that the Committee will vet the draft report with care, so as to avoid any unnecessary controversy over the way in which points are put. I agree that we must not let the report be dominated by the rare, highly publicised case where fraud is involved, although we must anticipate questions to the effect - what would your recommendations have done to prevent Maxwell, and so on?

The problem about, "auditing standards are currently higher than they have ever been", is that there is no way of measuring objectively the standard to which audit work is carried out. We have had a good deal of evidence about the effect of competitive pressures on auditing firms, plus items like the alleged letter bidding for the Pru's auditing business, which would make me cautious about any absolute statements on standards. I think the best approach is to say that expectations are continually rising and it is the gap which matters, not whether the gap arises from changes in expectations or in standards.

I agree that we should put more emphasis on the room for manoeuvre within accounting standards. Again, my caution would be that simply (although it is not simple to do!) tightening up standards will not of itself do all that is needed. I increasingly believe that everyone involved has to raise their sights.

May I finish by reverting to this question of why we were set up. Ron puts it down to growing loss of confidence in financial reporting; growing concern about the possibility of reckless management and major criminality; growing loss of confidence in accountants and audit as a protection against opportunistic financial reporting and reckless or

criminal management; and growing concern within the profession that it is not in a position to act as the safeguard people want and to stand firm against pressures from boards because of weak accounting standards and competition for business between auditors. He also cites as a lesser problem the difficulty of finding a balance between comprehensive accounts and providing the information needed to come to a well informed view about a company's performance and financial position.

Is this basically where you stand and would you be happy for our draft report to take these as the problems which we were asked to address?

You gave us a daunting task and I have had moments of despair. I think I see the way ahead more clearly now, subject to the way in which our 'retreat' goes on January 20th and 21st. No progress would have been possible without our indefatigable Secretary!

With best wishes

Yours

Adrian .

Adrian Cadbury