Takeovers are not the solution to keeping mgt. up to the mark.

Supervisory bds acting Philips/Kleckner

Upthon = Imports.

Indepdt. n.-eds. not appointed

Two-tier board.

Takeover is a myth

MEETING WITH N C. BAIN 22/8/91

As Chief Executive Bain led Coats Viyella's take-over of Tootal. In his view Tootal's accounts were misleading and he drew attention to the references to Tootal in the Plillips and Drew booklet. He is concerned that the accounting rules are too easily bent, auditors cannot or will not stand up for them and standards are slipping. He feels that boards must accept the responsibility for the integrity of the accounts.

Asked why chairmen should go along with misrepresentations which will eventually catch up with them, he says it is to buy time in the hope that something will turn up.

Areas of concern include, accounting for earnings in foreign currencies subject to high inflation,(US GAAP more realistic), off-balance sheet financing, extraordinary items and provisions.

Company reports should cut out the review of operations, "padding between pictures", move information from the notes to the text and turn hieratical comments into plain English. How information is disclosed is as important as what is disclosed. Reports should not try to be company marketing documents as well. Cash flow statements are key.

He puts great emphasis on audit committees, which should agree the scope of both the external and internal audits and question senior executives about the information which they have given to the auditors. Audit committees should be professional in their approach and report direct to shareholders.

Audit committees need effective NED's, who should therefore be properly selected, trained and paid.

The argument that we should not disclose more than our Continental competitors is weak. Bain says that you gain little of competitive value from accounts which you could not obtain by other means.

The climate needs to be changed to one where boards accept that it is their responsibility to present an accurate picture of their company's affairs, auditors' resolve is stiffened, high standards are supported and transgressors publicly censured. Guidelines are badly needed. THe Committee is in a position to help bring about change and to ensure the effectiveness of accounting standards.

AUDIT COMMITTEE

Background notes on Accounting Standards

1. Statutory

Current accounts are subject to the Companies Act 1985 as amended by the Companies Act 1989. Noticeable consequences in the published accounts are:

a) The full consolidation of associates under the concept of the UK company exerting a dominant influence over it. (e.g. India 40% ownership).

b) The disclosure of aggregate goodwill written off against reserves.

c) The exclusion of disclosure of employees' remuneration.

The amended Act also extends statutory effect to applicable accounting standards.

2. Accounting Standards

The accounting Standards Committee (ASC) set up under the aegis of the various accountancy bodies, has been replaced by the Accounting Standards Board (ASB) whose statements are mandatory on preparers of accounts.

During the year the ASC had issued a revised standard - SSAP4 Accounting for Government Grants - and a new standard - SSAP25 Segmental Reporting. The first has little effect and the second has been anticipated by most companies, being already a requirement for SEC registrations. It did however leave a number of exposure drafts outstanding, the most relevant of which are:

ED 47 Goodwill - would require purchased goodwill to be capitalised and amortised through P&L.

✓ ED 48 Acquisitions and mergers - would limit application of merger accounting in favour of acquisition accounting.

✓ ED 51 Fixed assets and revaluations - would prevent realised revaluation surpluses being included in P&L account.

ED 52 Intangible fixed assets - would, inter alia, require amortisation of costs capitalised through P&L account.

It is conjectural how the ASB will deal with these subjects, but their adoption would bring UK reporting of profitability generally closer to the US methodology so reducing the reconciliation between UK and US GAAP.

The ASB has set itself a target of producing three accounting standards this year, namely on:

a) Cash flow - where the emphasis will be on cash flows rather than differences between opening and closing balance sheets (SSAP 10).

b) Off balance sheet accounting - to reflect the substance of transactions on balance sheet (ED 49), which could impact gearing ratios.

continued ....

c) Consolidated accounts - a combination of existing SSAPs 1 and 14 (on which an interim statement has been published).

To date, the schedule for producing these documents has not been met.

In addition, the ASB has issued on a limited basis two discussion papers on:

1. Reporting of financial performance, and

2. Presentation of financial information.

   The first paper seeks greater disclosure of the effects of acquisitions and disposals whilst severely limiting the use of extraordinary items. The first objective is to be achieved by a columnar profit and loss account which is unlikely to be well received. The second objective may well be better received if it achieves greater comparability of companies' results. The second paper is conceptual in nature.

The ASB has created also an Urgent Issues Task Force (UITF) which has met once to consider:

i) Backdated supplemental interest in respect of convertible bonds, and

ii) Restructuring provisions.

A decision on these matters was deferred until the next meeting which takes place shortly. I expect the UITF to require provision of supplemental interest in the current P&L account as if there is no conversion of any convertible instrument and to specify more rigorous treatment of restructuring provisions.

The Financial Reporting Council, of which the ASB is one activity, has also set up a Review Panel to consider published accounts. This Panel has powers to bring about amendment of defective accounts.

W.

NCB/sm
12.6.91.