CAD-01269
Resignation of auditors
Timing of report

NIGEL MACDONALD'S COMMENTS ON THE CONSULTATION RESPONSES

1 Points relevant to aspects of report which Committee has agreed should be redrafted

Tone

1 Sir Richard Lloyd makes a good point when he says 'The monitoring/ financial reporting function, and checks and balances of power within a board, need to fit into that greater framework of corporate governance. We hope that your report could draw more attention to the larger framework so that the financial aspects of governance are seen more clearly in context.'

2 With regard to the comment by the Stock Exchange Listed Companies Advisory Committee that 'the draft report emphasises the duties and responsibilities of directors - it can be read as reducing those of auditors', and the CBI's criticism of 'the lack of balance in the Code which does not include any provisions for auditors' role in corporate governance' (pages 37 and 39 of responses by companies), it would be worth making the point that auditors have clear legal and professional responsibilities laid down by statute and by professional rules but they are not written into the Code because it is addressed only to companies.

Criticism that proposals will divide the board

3 Strongly supports Jonathan Charkham's suggested line that all directors have a supervisory responsibility in accordance with the requirements of the Companies Act, and that the difference between the executives and non-executives is not that the NEDs additionally have supervisory responsibilities but that the executive directors additionally have functional responsibilities.

Maxwell

4 Commends the comment by Touche Ross (p.27 of the responses by accountants) that the Committee should make clear that it does not expect to eliminate fraud, only to raise standards of corporate governance generally and to make the fraudster's life more difficult. [Could be worked in either at 1.7 or 5.24.]

The Code

5 Well worth making the sort of point made by Sir Richard Greenbury ('We do not believe that there is one board structure or format which is appropriate for every type of company, industry, or business culture') and Geoffrey Mulcahy ('The report and code must make crystal clear that there are different ways of achieving the ojectives.')

Formal schedule of matters reserved to the board

6 Does not think Committee was right to dismiss as too fussy the ICAEW's point that the schedule should be distributed throughout the company.

Disclosure of directors' pay (4.32 to 4.37, Code 3.2)

7 Perhaps worth working into the text the thought (prompted by Geoffrey Mulcahy's slightly different comment on p.33 of the responses by companies) that disclosure enables shareholders to assess the relationship between directors' remuneration and increase in shareholders' wealth. This is consistent with the Committee's stance of not saying that remuneration is too high or too low but that it must be disclosed.

8 Would be helpful to make more clearly the point in 4.32 that the requirement to explain the basis on which performance is measured refers to future performance related payments as well as those already made.

Non-executive directors

9 Report should explicitly make C M Stuart's point (p.19 of responses by companies) that NEDs should involve themselves in thoroughly understanding the major decision-taking activities of the board.

Nomination Committees (4.13, 4.24, Code 2.5)

10 The recommendation at 2.5 of the Code (4.13 of the report) should be amended as suggested by the CBI to cover all directors. (This would improve consistency with 4.24, on nomination committees, which states that such committees are to be responsible for making proposals on all board appointments, whether executive or non-executive.)

Audit Committees

11 Geoffrey Wilson's point that the audit committee should report regularly to the board (p.29 of company responses) should be made specifically, eg in a redraft of the first bull point of 4.29.

Internal control

12 Worth taking on board the ICAS's comments that 'No one model of internal control can apply to all companies. We therefore suggest that the directors' report should reflect what actually happens in the company rather than having a standard imposed applicable to all companies. Also, the cost/benefit analysis as to the appropriate system of internal control must be tailored to suit the company.'

Going concern

13 4.6 should remain in the Code but should be subject to a footnote saying that the provision does not come into effect until the APB have issued guidance.

Issues to be logged for the successor body

14 Directors' training; communications between listed companies and the financial community (see ICAS's comments on p.32 of responses by accountants); and role of shareholders generally.

2 Detailed points which need to be considered

15 Points are as follows:

- Title of the Code (Code of Practice/Good Practice/Best Practice).

- The numbering of the Code should be differentiated in some way from that of the main report (Law Society point).

- Expression 'mutual benefit' at end of 4.14 should be redrafted - it has overtones of the NED drawing a comfortable fee (Law Society point).

- The reference in the second line of 4.24 to chairmen 'making' appointments should also be redrafted (Law Society point).

- Point by two company respondents (p.32 of summary) that 3.1 of the Code, on directors' service contracts, should apply only to future contracts, in line with 4.33 of the text.

- The section on interim reports (4.47) needs to acknowledge that companies should not be required to incur the cost of revising specialised valuations of assets or liabilities for interim reports. An extra recommendation is needed to the effect that accounting rules to apply to the preparation of interim financial statements should be developed by the ASB. (See summary of responses by accountants, bottom of p.20.)

3 Other comments

16 The Chairman: likes Neville Bain's suggestion that the chairman should be encouraged formally to appraise the role of the board annually and make the time to talk to each director about their perspective of the board's effectiveness.

17 Number of directorships: Committee should consider suggestion by GKN that companies should be required to disclose, in respect of each director, all non-executive directorships of quoted plcs to make it easier for shareholders to assess whether they have sufficient time to be effective directors of the company.

18 Directors' training: likes CIMA's proposal that there should be a specific recommendation that all directors should ensure they are fully aware of their duties and obligations and that they should receive appropriate training. Believes it would be uncontroversial.

19 Independence of NEDs: sympathy for CIMA's comment that companies will often want to appoint NEDs with a knowledge of the industry in which they are operating. Since they will not wish to appoint the executive directors of competitors as NEDs, they may look for the necessary expertise among the executive directors of customers and suppliers. (CIMA go on to say that 2.2 of the Code should not be allowed to prohibit this, although such directors should not serve on the audit or remuneration committees.)

20 <u>Minimum number of non-executives</u>: Committee should revert to the question of whether it should explicitly specify a minimum number of NEDs. The Committee's position has to be deduced from the proposals on audit committees, which require a minimum of 3 members, all NEDs, 2 of whom must be fully independent. This line should be stated more clearly; and a concession should be considered for small companies along the lines that an executive chairman may take the place of the third (not-independent) NED provided that on the audit committee the chair is taken by one of the two independent NEDs.

21 <u>Audit committees</u>: likes Arthur Andersen's suggestion that the report should contain a statement of the purpose of audit committees, rather than just a recital of their tasks, namely

- understanding, assessing and monitoring the overall control environment;
- promoting sound financial reporting;
- upholding standards of business conduct.

22 <u>Internal control</u>: Committee might consider including in 4.25 to 4.26 the Treadway Commission's definition of internal control (p.26 of responses by companies). Committee might also consider working in Arthur Andersen's point: 'So that there can be no doubt as to the breadth of the recommendations, we suggest that a definition of internal financial control be included so as to emphasise that it embraces not only the safeguarding of assets but also addresses the management information needed to control the business.'

23 <u>Financial reports</u>: CBI's proposal that 4.4 of the Code ('It is the board's duty to present a balanced and understandable assessment of their company's position') should be made more specific, eg by incorporating from 4.41 that the report and accounts should contain a coherent narrative, supported by figures, of the company's performance and prospects, on the basis that 'words are as important as figures'; and that setbacks as well as successes should be dealt with.

24 <u>Rotation of auditors</u>: well worth putting in a plug for independent review by other partners of the work carried out by the main partner - a widespread but not obligatory practice. Would like to see the line in 5.12 strengthened, by adding after the second sentence 'Accordingly the Committee concluded that proposals for obligatory auditor rotation would not be in the company's or the public interest.'

25 <u>Extension of the auditors' role</u>: supports point made by Touche Ross that final report should refer to the need to balance costs and benefits.

26 <u>Shareholder communications</u>: likes Grant Thornton's suggestion that directors who resign should be required to make a statement of circumstances that need to be drawn to the attention of members.

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