

hi Adrian

I have acknowledged, &
will circulate to the
Committee.

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The Hundred Group of Finance Directors

Chairman: Hugh R. Collum
Secretary: Richard Q.P. Tannahill

3rd September 1992

Mr. Nigel Peace,
The Secretary,
Committee on Financial Aspects
of Corporate Governance,
P O Box 433,
Moorgate Place,
London EC2P 2BJ.

Dear Nigel

I apologise for the delay in letting you have The Hundred Group's comments on the Draft Report. Holidays and overseas travel made this a difficult exercise! The attached paper deals with what we regard to be the major issues, together with an Appendix with some supplementary minor points.

Our comments do not introduce any new arguments, but we are particularly concerned about the voluntary nature and consequently the monitoring of the proposals. The action required by companies to back up the implementation of the Code of Practice is likely to be more pro-active than hitherto; this, and pressures from the auditors, will keep the internal commitment at a reasonable level. Externally, as currently proposed, the threat of bad publicity and a more active and challenging involvement by the institutional shareholders, may also help to keep the appropriate pressure on management. The knowledge that there will be a further review in two years time could be a timely reminder that action is required now or else!

We have not canvassed the whole of our membership but our views have been co-ordinated through our original Corporate Governance working party. I do know that some of our members have strong reservations about the voluntary nature of the proposals and there is also some support for the controversial views raised by Owen Green in The Financial Times in June!

Again, sorry for the delay

Yours sincerely

ASB



**The Hundred Group
of Finance Directors**

COMMENTS ON THE CADBURY COMMITTEE'S DRAFT REPORT ON
" THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE"

1. Introduction

1.1. The Hundred Group working party that submitted the initial Hundred Group Report was reconvened to review the draft Cadbury Report. The working party was generally supportive of the recommendations and the need for a Code of Best Practice.

1.2. The consensus of views was that the draft report has encapsulated most of the financial aspects of corporate governance and has very significantly raised the level of debate, but there is still a need for some aspects of the Code of Best Practice and the other recommendations to be more positively stated.

1.3. As all listed companies are expected to comply, there are two particular areas where there must not be misunderstanding:

(i) how will the implementation be monitored?

(ii) how will compliance by the listed company be recognised?

2. Monitoring

2.1. The working party is disappointed by the decision of the Stock Exchange not to treat the Code as part of the listing agreement. Even with the current good intents and the threat of bad publicity for non-compliance, the lack of a specific requirement for compliance will not help the establishment of the Code of Practice. The working party appreciates that the CBI may have reservations concerning potential bureaucracy, but would suggest that the current problems would not have come about if there had already been in place more formal procedures for most of the corporate governance aspects now being reviewed.

2.2. The Committee strongly recommend that either the Stock Exchange reconsiders its position or alternatively the powers of the Financial Reporting Council are extended to give them the responsibility to review on an ongoing basis the level of compliance by individual companies.

2.3. It is probable that most listed companies have, over the past few months, reviewed their existing corporate governance status. In the current atmosphere where change is felt to be desirable, it would be unfortunate if this opportunity is not taken to put in place some formal system for monitoring this in future.

3. Compliance

3.1. The complications of compliance became more evident the longer the issues were discussed. Specific guidelines are going to be required and these should be available by not later than the date when the final Cadbury report is implemented. Piecemeal introduction of different aspects is not felt to be the best way forward.

3.2. The auditing of the Compliance Statement was criticised due to the need to look at both the qualitative aspects and the more factual elements. The working party agrees with some of the comments of the Auditing Practices Board that it may be appropriate to split the code into two sections thus removing the subjective element from the auditors endorsement.

3.3. The introduction of compliance requirements must take into consideration the benefits that will be achieved versus the cost that will be incurred. There is a suspicion that the proposed changes will be used as an excuse for further increases in audit fees.

4. The Board of Directors

4.1. It was felt that strong support for the unitary Board structure should be stated in the report.

4.2. The working party felt that there had been some over reaction about the relationship of the non-executive directors and executive directors, but there is an important need for this to be clarified in the final report. Similarly the idea of an appointed leader for the non-executive directors was considered potentially divisive and detracted from the concept of a unitary Board.

5. Self-Regulation

The working party strongly supports the self-regulatory nature of the proposals but does feel that the value of this will be considerably lessened unless the monitoring and compliance issues referred to above are satisfactorily resolved.

6. Cadbury Committee Recommendations

The attached Appendix deals with some more detailed points arising from the Code of Best Practice and the Summary of Recommendations.

CADBURY COMMITTEE DRAFT REPORT ON "FINANCIAL ASPECTS OF
CORPORATE GOVERNANCE" - CODE OF BEST PRACTICE

(draft report pages 42/43)

(Paragraph numbers refer to the numbered
paragraphs in the draft report)

1. Board of Directors

1.1. The Minutes should be comprehensive and should record discussions as well as decisions. In some cases, they should also reflect the background/environment in which the decision is made.

1.4. Decisions affecting the day to day operations and longer term policies are often taken by an Executive or Management Committee; this may lead to the view that the number of Board meetings could be cut back which in turn reduces the role of the non-executive director. This emphasises the importance for the information requirements of the Board and matters referred to them for decisions to be clearly defined and regularly reviewed.

2. Non-Executive Directors

2.2. It was not felt necessary for a minimum number of non-executive directors to be stated. The number of non-executive directors should be of sufficient critical mass for them to carry out their duties relative to the size of the Board.

2.3. Procedures should be in place for a positive re-appointment of a non-executive director with the understanding that the total length of appointment should not exceed two terms of three years.

2.4. The opportunity to obtain outside legal advice should be available to all directors (executive and non-executive). A suggestion that there should be a cost cap was felt to be inappropriate.

The nature of advice should be restricted to checks and balances to do with corporate governance but should not be allowed to extend to operations and strategy.

It was felt that if a director was preparing to obtain outside legal advice, he should notify the Chairman accordingly.

2.5. The procedure may need to be less rigid for smaller companies.

3. Executive Directors

3.2. The compensation of the Chairman and the highest paid director should be shown in detail. Phantom options should be disclosed and treated in the same way as ordinary stock options.

3.3. It would seem that non-executives pay should be set by the Remuneration Committee and not be subject to recommendation.

4. Controls and Reporting

4.1. It was suggested that whether or not there was an Audit Committee, the auditors should appear in front of the full Board when the full year's accounts are approved.

It was suggested that the sentence in the Code of Practice should omit the word "effective".

4.2. The inclusion of this paragraph is not disputed, but directors should be aware of the implication as to whether a liability arises if a report gives a clean bill of health which subsequently turns out to be ill-founded.

It was suggested that the statement on internal control should state how the system is working by reference to procedures, not simply that it is working satisfactorily.

It must be emphasised that management are responsible for internal controls and that the auditors role is only that of a monitoring nature.

4.3. This paragraph would seem to be superfluous.

4.4. To a large extent this will be covered by the operational and financial review.

4.6. The whole premise of the Annual Report and Accounts of a company is that they are prepared on a going concern basis. In view of the embarrassment that this may cause some companies, advice will be required on the publication of assumptions and qualifications.

4.7. Committee chairmen at AGM's should be expected to deal with questions about the work of their respective committees but they should not be dealing with policy issues. This was felt to be the responsibility of the Chairman of the Board.

Appendix (contd)

CADBURY COMMITTEE DRAFT REPORT ON "FINANCIAL ASPECTS OF
CORPORATE GOVERNANCE - SUMMARY OF RECOMMENDATIONS

(draft report pages 42/43)

(Paragraph numbers refer to the numbered paragraphs in the draft report)

2. The starting date for companies reporting compliance with the Code of Best Practice should be recommended as 31.12.92 as good practice, but mandatory for accounting periods ending on or after 31.12.93. It was felt that, if possible, all proposals should be implemented at the same time supported by the related guidelines.
3. See covering memorandum (paragraph 3.2).
4. The role of the institutional shareholders will be important if this initiative is to be successful. It should become normal practice that institutions in the course of their meetings with listed companies should discuss the subject of corporate governance and the degree of compliance with the Code of Best Practice.
5. A two year review is strongly welcomed.
6. It is recommended there should be a minimum of two meetings per year, rather than three.

8. Whilst supporting the principle, there was considerable concern that there would be both additional cost and delay in preparing interim reports with the auditors having little or limited responsibility for the review of them. It is normal practice for interim statements to be reviewed by the auditors 'for comfort' but, for the future, clear guidelines are important to avoid misunderstanding and excessive cost being incurred by the auditors. At the interim report stage, the review could possibly be limited to discussion on major current and potential issues which may not only affect the accounts being issued but also the year end outcome.

It was felt that the inclusion of a Cash Flow statement would be of more benefit than a Balance Sheet which should be optional.

10. The principle of rotating audit partners was considered fair but difficulty was expressed on being prescriptive about the time period. There was some sympathy with the view that the UK should adopt the USA practice where the partner in charge is required by law to change every seven years.

11 to 16

No comments but continuing reservations about the Caparo situation.

Other

1. There is a need for a stand-alone Code of Best Practice. This should refer to the Board being treated as a single unit and should make the point that the mechanism for enforcement ranks equally with the rules themselves.
2. There was some feeling that the report has been too generous to the auditors and that subsequently Institute committees have been created to review and to make recommendations to rectify issues which should have been addressed some years earlier. With this in mind the guidance notes to support the Code need to be specific and take into account the views of preparers of accounts and the contribution that could be made by an internal audit department, where this exists.

31st August 1992