CAD-02105

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Ack'd

21st July 1992

Dear Sir Adrian,

Committee on the Financial Aspects of Corporate Governance

I have set out in the enclosed note some comments on the Committee's draft Report which I trust will be helpful in finalising your conclusions.

The note expresses my views and those of other Board members, including the Finance Director, of Glaxo Holdings.

Yours sincerely,

P Girolami

Paul Girolami

Sir Adrian Cadbury,
c/o Secretary,
Committee on the Financial Aspects of
Corporate Governance,
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THE DRAFT REPORT OF THE CADBURY COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE

A Glaxo View

A reading of the Cadbury Report reveals a paradox. There is much in the specific recommendations and Code of Best Practice which can be fully supported. Most of the provisions of the Cadbury Report exemplify accepted principles of good corporate governance; Glaxo already conducts its affairs and procedures according to the great majority of them.

Despite agreement with the specifics, we are left with an underlying concern that the genesis of the Committee's task has led it, first, to depart from its declared terms of reference; thence to adopt and express a narrow view of the role of non-executive directors and to provide very little commentary on the role of executive directors (in particular, in this context, that of the Finance Director); and, finally, to admit into its precepts a persistent element of constrictive formalisation which we doubt will serve the long-term interest of efficient and energetic corporate governance.

The Committee's terms of reference were to examine certain issues "in relation to financial reporting and accountability". These issues included the responsibilities of executive and non-executive directors for reviewing and reporting on performance. The report uses this remit as the basis for a considerably wider review of the role of non-executive directors and their relation to the executive directors. This takes the Report into areas of corporate governance which have little to do with "financial reporting and accountability".

We feel that, as a consequence, the Report goes too far in formalising the separate role of the non-executive directors. In the longer term several of the Report's recommendations, and much of its supporting argumentation, could create a tendency to factionalism within the boardroom.

This might be necessary if the role of the non-executive directors were solely to prevent lapses of corporate governance of the type infamous in recent years. It would then be reasonable to conceive the non-executive directors as the watchdogs or guardians of the shareholders', or even the public, interest, and to provide them with the necessary framework to exercise that role.

We do not see this as the only -- or even primary -- role of the non-executive directors. They bring to the boardroom independence and outside experience which cannot be provided by the executive directors, and those qualities are (or ought to be) deployed to enhance the general decision-making of the Board on all the aspects of corporate affairs with which it has to deal. The constructive harnessing of this spectrum of experience requires the creation of a team ethos.

For this reason, it is difficult to support the Committee's concept of a "leader" of the non-executives, whether formally appointed or not. The idea of a countervailing power is inimical to the effective operation of a unitary Board which brings a range of different skills and experience to bear on the problems and opportunities faced by a company.

The Committee itself admits that the cadre of non-executive directors is not there simply to restrict or police the actions of the executive directors. Yet the concentration upon this aspect of the role of the non-executive directors which permeates the Cadbury Report could be damaging to the creative balance between non-executives and executives which most companies seek to achieve. If the Committee was right to move outside its financial remit, it should have reviewed the role of the non-executive directors in its fullest context, and not merely partially, in order to establish a balanced view.

In accord with its remit, the Committee has frequent regard to the role of auditors. However, one consequence of the Committee's having, in other respects, moved beyond its terms of reference, is that the auditors are invoked to perform duties relating to aspects of corporate governance not normally within their special field of expertise.

Auditors are to be required to comment on the Board's statement of compliance with the Code of Practice. At points, the Code goes well beyond purely financial matters. The auditors will therefore be required to comment, for example, on "the calibre and weight" of the non-executive directors. As another example, the Board's statement of adherence to the Code must be taken to imply that "no one individual has unfettered powers of decision". This can be easily declared, yet the only power of validation lies in the duty of auditors to comment on the Board's statement of compliance. Further, if a Board decides that compliance with one or more aspects of the Code is not in the interests of the company concerned the auditors would be expected to pass some kind of judgement on this decision. Is the Committee clear about the extent to which it is asking auditors to assume responsibilities beyond their usual professional limits?

We would now like to comment on some of the specific aspects of the Code of Best Practice and the Committee's recommendations about which we have some reservations:-

Code Paragraph 2.4 - Agreed procedure for non-executive directors to obtain independent external advice: This proposal reflects the Committee's bias in respect of the role of non-executive directors, but is nevertheless a sensible idea providing it is extended to all directors and is restricted to advice on the individual director's position vis-a-vis the company. It is not, however, clear whether the Committee considered fully that the operation of this clause may encourage, if not force, non-executive directors to surround themselves with external advice in case of subsequent litigation.

Code Paragraph 2.5 - Non-executive director selection should be a formal process with Nomination Committee selection and nomination by the Board as a whole: The formality of the apparatus proposed (in paragraphs 4.24 and 4.13 of the Report) is excessive. Its intention appears to be to introduce an objective "trawling" of the market of the kind which might precede the appointment of an outside senior executive. The adoption of such formality will not prevent what it is intended to prevent in those companies where prevention is needed, and will merely constitute an irritating ritual in those companies where it is not.

Code Paragraph 4.1 - The establishment of an effective audit committee: Several of the specifications in the Committee's discussion of Audit Committees will tend to generate a potential for faction. For example, the Committee proposes that the Audit Committee should meet formally with external auditors once a year with no executive Board member present. Many companies run sound Audit Committee/auditor relations on the basis of informal links which serve well to advance the cause of effective audit. The Committee also proposes that the Audit Committee should recommend the external auditor appointment and fee. It seems to me that this recommendation could have the effect of identifying the auditors with the non-executive director group, rather than with the board as a whole.

General comments (passim): Certain of the Committee's general comments, which fall outside the remit of financial reporting -- for example, those relating to the need for general statements of corporate governance, the review of information services to non-executive directors, the training of directors, the desirability of published statements of business ethics -- seem not to have been fully worked out, and their objectives and important practical aspects of their implementation require further elaboration. It is also notable that the Committee gives little attention to the nature of financial reporting (as opposed to financial aspects of corporate governance).

Sir Paul Girolami
Chairman
Glaxo Holdings p.l.c.

20 July 1992