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SEC/NCP/KS

20th July 1992

Mr N Peace
Secretary
Committee on the Financial
Aspects of Corporate Governance
PO Box 433
Moorgate Place
London
EC2P 2BJ

Dear Sir

CADBURY COMMITTEE REPORT

1. The Cadbury Committee was set up by the Financial Reporting Council, the London Stock Exchange and the accountancy profession to deal with the financial aspects of corporate governance. With this parenthood and the institutional nature of its membership, it is perhaps not surprising that the Committee
 - makes numerous recommendations about the powers which should be conferred on non-executive directors with hardly a mention of the role of executive director;
 - whilst acknowledging the shortcomings of existing accounting standards and practice, makes no recommendation as to how those shortcomings can be rectified;
 - seems to regard it as axiomatic that auditors who have differences of opinion with management cannot be expected to put their views frankly in the presence of any executive director;
 - in considering the respective responsibilities of directors and auditors in respect of a company's financial statement, endorses the limitation on auditors' liability in accordance with the principles laid down by the House of Lords in Caparo while accepting without question the unlimited responsibility of directors.

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2. We in general nevertheless accept the spirit in which the Cadbury Report has been put forward and endorse the principles of openness, integrity and accountability on which the Code of Best Practice contained in the Report is based. There are, however, several recommendations in the Report which in our view would undermine the effectiveness of a unitary board of directors. We comment below on these and other recommendations with which we disagree.
3. The Committee's perception as to what constitutes an effective board is based on the premise that there should be a balance or division between executive and non-executive directors. Thus, in paragraph 4.3 it is stated that "a senior non-executive director should be appointed to take the lead in order to maintain the balance between the executive and non-executive influence". Similarly the last sentence in paragraph 4.6 states that "where the Chairman is also the Chief Executive, it is essential that there should be a strong independent element on the board with an appointed leader". In our view, institutionalised polarisation of this sort will inevitably detract from the effectiveness of a board and the efficiency of operation of the business and should be resisted.
4. The so-called control function of non-executive directors referred to in the Report is largely overstated. We also find it surprising that recommendations concerning the structure of the board and the responsibilities of its members are made without discussion of the position in other jurisdictions where the executive and supervisory aspects of the duties of directors are separated or of the proposals contained in the EC Fifth Directive on Company Law. The whole thrust of the Report is to retain the unitary board but to attempt to engraft a two-tier structure on to it. This is not a workable arrangement.
5. We agree with the recommendation that non-executives on a board should be independent and free of any business or financial connection with the company but do not understand why this recommendation should not apply to all non-executive directors. In addition, in our view reciprocal arrangements between directors should be proscribed. Thus, if an executive director of company A is a non-executive director of company B, an executive director of company B should not be eligible to be appointed as a non-executive director of company A.
6. We do not believe that non-executive directors should have any general entitlement to take independent professional advice at the Company's expense as envisaged in paragraph 4.12. Indeed, we do not understand why the position of non-executive directors is any different from that of executive directors in this respect. We cannot see the advantage in encouraging different groups of directors with separate legal and financial advisers to engage in conflict. Rather than increasing the effectiveness of the board, this recommendation is liable to lead to disruption of the business, public argument and incurring substantial costs over which the company has no control.

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7. We do not regard it desirable or practicable to specify what matters are reserved for decision by the full board as contemplated by paragraphs 4.19 and 4.20. In our view, all matters are for the full board except those that have been expressly delegated to committees of the board. It is not unusual for listed companies to have a board committee to deal with material operating matters in the period between board meetings. We have a General Purposes Committee whose terms of reference require a non-executive director to be present for it to be quorate.
8. The functions of an audit committee are two-fold. First, particularly in a complex group with numerous operating subsidiaries, the committee is an extension of the board appointed to assist the board as a whole and each of the individual directors, both executive and non-executive, in discharging their duties to shareholders. Secondly, the audit committee should review and monitor the way in which the financial function is carried out, with particular regard to internal control systems within the company.

Reference is made in paragraph 4.27 to the New York Stock Exchange requirement that all listed companies should have audit committees composed solely of independent directors, but no mention is made of the U.S. corporate practice of separating its officers and management from the board of directors. Whilst we agree generally with the recommendations in paragraphs 4.29, we do not agree with the recommendation that membership of the audit committee should be confined to non-executive directors. We believe that greater flexibility is desirable and it would be sufficient to provide that a majority of its members are non-executive directors. Nor do we agree that the chairman of the audit committee should be responsible for answering questions at the annual general meeting. The chairman of the meeting is responsible to shareholders at the annual general meeting and in our view he should deal with all questions, calling on board colleagues as and when necessary or desirable.

9. We do not agree with the recommendation to expand the contents of interim results in the manner contemplated in paragraph 4.47. The additional costs which would inevitably be incurred by such an exercise would be to the detriment of shareholders without in our view providing any material benefit.
10. Whilst we agree with the recommendation in paragraph 5.11 that it is good practice for auditors to keep under review the non-audit fees paid to the company's auditors, we do not believe that disclosure of such fees is likely to serve any useful purpose. The periodic change of audit partners recommended in paragraph 5.12 should be left for agreement between the board of the company, advised by its audit committee, and the firm concerned. We do not think that arbitrary change of audit partners, with inevitable incremental costs, is sensible.

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11. We are surprised at the statement in paragraph 6.2 that the shareholders elect directors. It is the inevitable practice in listed companies for directors to be appointed by the board and to offer themselves for re-election periodically. Nor do we think that, as owners of shares in listed companies, shareholders have any responsibilities to the company as such. Shareholders have rights as owners which at their absolute discretion they may or may not choose to exercise. The statement in paragraph 6.3 that "shareholders have delegated many of their responsibilities as owners to the directors who act as their stewards" is confused. Whilst we accept that accountability to shareholders will be strengthened if companies are required to comply with the spirit of the Code of Best Practice, we do not believe that strict adherence to every detail is necessary in what is after all a voluntary system.

Yours faithfully



N C Porter
Secretary