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10th July 1992

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

Adh'd.

Dear Mr. Peace,

THE DRAFT REPORT

I have read with interest the draft Report of the Committee on the Financial Aspects of Corporate Governance and heartily endorse the aims and objects of the Committee. I would provide you with my personal comments on the draft Report which I must stress are not necessarily the views of my partners or my firm.

- (1) Although I endorse the aims and objects of the Committee, I do believe the comment at T.7 is a little high-handed and of dubious content and value.
- (2) I believe that in general terms the vast majority of companies conduct their business with honesty and integrity and it is unfortunately very British to be considering bringing in a code of practice which is really intended to force the minority to put their affairs in order when possibly a substantial element of this minority will either ignore the proposals or pay lip service to them. If a powerful executive sets out to operate fortunately then I do not think that the code of best practice will be any more effective than civil or criminal law.
- (3) I do appreciate that there is a counter-argument that if the vast majority of companies are already conducting their affairs properly, then to actually comply with the code of best practice will take very little effort on their part. I would accept that this is probably the case.
- (4) However, the point at issue is to what extent a code of best practice will in fact prevent fraud. I have no doubt that such a code would lead to fewer failures through mis-management and may even prevent some fraud, but I do not believe that

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there is any question of such a code of practice preventing all fraud.

- (5) On the subject of public perception and the expectation gap, there will always be a perceived conflict where the auditor reporting upon the financial statement is in fact remunerated by the company. Unfortunately I believe that this expectation gap can only be narrowed with the implementation of an independent statutory auditing authority. This is a total anathema as far as I am concerned but then on this aspect I am an interested party and not merely a member of the public.
- (6) As the report quite rightly highlights, auditors do operate in a competitive market and although they are effectively appointed by the shareholders and paid by the company, it is the directors as managers with whom the auditors deal in the main. The directors too are in turn appointed by the shareholders. Again, whereas I endorse the suggestion of three year service contracts for directors, I see little other positive action which will improve this unsatisfactory position.
- (7) I would not like to name names but I have a perception that there are certain companies which have failed recently which would have been unlikely to state that they had failed to comply with the code of best practice.
- (8) Companies, like auditors, also operate in competitive markets as again highlighted in the report. Whereas I endorse the aims and objects of the draft Report, I can see increased costs in Non-Executive Directors' fees and training. Indeed there seems to be an inference in the Report that untrained Non-Executive Directors should be appointed and then trained at the expense of the company. I can in fact see a desire by Executive Directors and Shareholders to appoint readily trained Non-Executive Directors. Again, these additional costs will be borne by all companies when the real object of the exercise is to bring improvements to a minority of companies.
- (9) I read with interest the proposals regarding additional reports to be included in the Accounts for internal control and going concern and the requirement of auditors to report thereon. I was trained to believe that an unqualified Audit Report effectively endorsed a company's system of internal control and similarly, if an Auditor did not believe that a company was a going concern, then he would qualify his report accordingly. Again, there is a distinct possibility that these draft proposals will in fact lead to additional costs, presumably in the form of audit fees. Whereas as an auditor I should be delighted, in the current economic climate I would envisage most companies endeavouring to reduce costs rather than increase them. I do appreciate that in theory the increased costs should overall reduce the number of company failures but again, as with the Poll Tax, it would seem that the majority are to be penalised for the sins of the minority.

In conclusion, I would comment on the fact that unfortunately most of my observations appear to be of a negative nature but this is probably due to my professional training! I am in favour of the concepts of the Report, if sceptical as to how much additional cost will be involved and how this is to be borne.

If this really is the way ahead for corporate governance then surely the Institute of Chartered Accountants in England & Wales should lead the way by reorganising its own management in this fashion.

Finally, I shall be grateful if you will let me know whether the Report, in its draft form, has been circulated to the Chairmen of all listed companies for their comment and I shall be grateful if you will kindly provide me with a further ten copies of the Report for internal and external distribution.

Yours sincerely,

N. C. Kelleway.

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