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Dear Mr Peace

**COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE
GOVERNANCE - DRAFT REPORT**

We should like to submit the following comments on the draft report of the Committee on the Financial Aspects of Corporate Governance:

General

We are a little sceptical as to whether a voluntary approach to improving corporate governance will be effective and note that our concerns are shared by many commentators. Indeed Mick Newmarch of the Prudential is reported as saying at the ICAEW Annual Conference that "by and large self-regulation fails." We find it difficult to believe that the Code could have prevented some recent scandals, as it leaves too much room for interpretation by the unscrupulous chairman or managing director.

However, we recognise that statutory intervention is unlikely in the foreseeable future and therefore broadly welcome the Report, which we believe represents at least a significant step in the right direction. Whether a voluntary approach will work in practice remains to be seen, so we welcome the recommendation that the Report's sponsors should review the success of the Code in two years' time.

The comments which follow on specific matters accept the voluntary approach, but seek in some areas to make it more effective.

Chairman

We believe that it would be preferable for the Code to insist upon the separation of the posts of Chairman and Chief Executive rather than requiring a *clear division of responsibilities at the top of a company*. This

requirement appears to be too open to interpretation to be fully effective in securing its objectives. We recognise that some very successful companies combine the two posts, but separation of them is in the best long-term interests of shareholders, as it guards against potential conflicts of interest and helps to ensure that the Chairman can when necessary take an independent view.

Non-Executive Directors

The draft report places great weight on the role of non-executive directors as guardians of the interests of the shareholders, who for largely practical reasons cannot exercise effective control over the executive directors. In order for non-executives to fill this role, we feel that some sections of the Code need to be tightened up so as to ensure that their objectives are achieved. We believe that there is still some considerable way to go in making non-executive directors the champions of the shareholders rather than people selected by the executive directors for their names, contacts or political influence.

The Code states that *the calibre and number of non-executives should carry significant weight in the board's decisions*. This seems to be too open to interpretation to be entirely satisfactory and we believe that the Code should indicate what minimum proportion of non-executives is required. At least some guidance on numbers should be offered.

It will in our opinion be necessary to have a fuller definition of independence. As well as considering business and financial links, close personal friendships with executive directors and previous employment by the company should also be considered, as should also any non-executive posts held on other companies by executive directors. If an executive director serves as a non-executive on another company's board, there should be a presumption against executive directors from that company fulfilling a non-executive role.

The Code states that a majority of non-executive directors should be independent. Given that the proportion of non-executive directors is left to judgement, it seems possible that the independent element could end up being too small to be effective. We feel that there is a good case for saying that all non-executive directors should be independent.

The recommendation that non-executives should serve only for a finite time is a sensible one, which should help to preserve an independent approach.

Nomination of non-executives by the board (even if it involves a nomination committee) concerns us, as it may undermine independence. However, it is difficult to see a

practical solution to this difficulty, although we hope that institutional investors will take an interest.

Directors' Remuneration

Directors are appointed as agents to manage the company on behalf of its owners, the shareholders. It therefore seems right that full disclosure of remuneration should be given in the annual report and accounts director by director, rather than in aggregate with complete disclosure only for the chairman and highest-paid director, distinguishing as the draft report suggests between base entitlement and performance-related elements. Present practice is to be rather coy about such figures, but it seems to us that shareholders have a right to complete transparency in this area. Furthermore if directors are doing a good job and giving good value for money, then there should be no embarrassment. Such a reform would require amendments to company law in due course.

Financial Reporting

Although it may lie somewhat outside the Committee's terms of reference, we should like to stress our view that very radical reforms of accounting practice are required in order to make financial statements meaningful and relevant. These go way beyond the additional disclosure which the Report recommends.

We hope that these comments will be of value to the Committee in reconsidering the draft report and look forward to seeing the final product.

Yours sincerely



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