



Mr Nigel Peace  
Secretary  
Committee on the Financial Aspects  
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KBH/M-KH225/1

31 July 1992

Dear Sir

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

We are pleased to respond to the request for comments on the above draft report. We support the aims of the committee's review and most of the proposals made. We comment below in both general and specific terms. Where we have not made any comment on a point in the report, this implies that we think it is satisfactory.

**General**

1. We support the idea of a "Code of Best Practice" (the Code) but feel there will be a need for statutory backing for some aspects of this, for example the directors' report on the effectiveness of their system of internal control.
2. As auditors, we predict particular difficulties in reporting on compliance with a voluntary code rather than legislation. An example of an area where this may cause problems is the directors' duty to prepare a balanced director's report. The APB are expected to provide guidance to auditors on endorsement of compliance with the "spirit" of the Code - we are not surprised that the Board has indicated that this reporting could be very difficult.
3. We agree with the idea that the code must be kept up to date, the first of a series of reviews being in two years' time.
4. We believe that many private companies would wish to follow the Code but could be deterred by some aspects which are frankly unrealistic for the smaller concern. If the Code meets with general approval and this idea is progressed we would wish to promote a "scaled down" version of the Code for the majority of our clients.
5. There is a very heavy emphasis on the role of non-executive directors throughout the report. We feel that the role of non-executive directors is over-emphasised. In particular, we do not see the merit of appointing a "leader" of the non-executive directors. The role of all directors is important and they are all expected to behave with integrity. We must not lose sight of this fact in an effort to strengthen the role of the non-executive.

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## Code of Practice: Specific Points

### Board of Directors

6. We agree that division of responsibilities at the head of a company is vitally important. We believe that the Code should prevent the chairman and chief executive from being the same person.
7. We agree that directors need training. Too many directors accept the position having no appreciation of the remit of their role or their legal responsibilities.

### Non-executive Directors

8. Reappointment of independent non-executive directors appears to be the responsibility of the board. This raises the question of the ease with which a "troublesome" independent party could be removed from office.

### Controls and Reporting

9. It would be a good idea to regulate directors' reports to encourage the setting out of more balanced views.
10. A report by the directors on the effectiveness of the system of internal control would be very useful but it would represent a fundamental change in the nature of an audit for auditors to report positively on the internal controls. This change and its consequent difficulties and expense should not be underestimated.
11. We agree that an explanation of the respective duties of directors and auditors would be useful for shareholders and other users of financial statements. We believe this explanation should be given on one page with reference to that page made in the audit report.

## Areas other than the Code

### Audit Committees

12. We agree with the usefulness of audit committees and support the proposals made, however their practicability in smaller companies is questionable.
13. We support the proposal that the Government introduce legislation to extend to auditors of all types of companies statutory protection which will enable them to report reasonable suspicion of fraud freely to the appropriate investigatory authorities. In the first instance, of course, suspicions could be discussed with the audit committee when no executive directors are present.

### Enhanced Objectivity of the Audit

14. Rotation of audit firms is not a practical idea. Rotation of audit partners is much more feasible and if properly controlled, just as effective. The Chartered Institutes should introduce appropriate ethical guidance in this area.

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15. Fees for non-audit work are currently disclosed in financial statements. We are unsure how useful a breakdown between "UK" and "worldwide" would be.

## **Enhanced Effectiveness of the Audit**

16. Going concern is a concept which is largely misunderstood both by directors and the general public. We support the proposals that directors should state in their report that the business is a going concern and provide supporting evidence of this to the auditors. The accountancy profession has recently issued guidance in the form of a proposed new auditing standard on which we shall be commenting separately.
17. We do not believe the scope of auditors' work should be extended to investigating and reporting on illegal acts since they lack the legal expertise required to do so.

Yours faithfully

*Neville Russell*

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