

COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

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Sydney Treadgold
Secretary
Financial Reporting Council
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Dear Sydney

Successor Body

1. We spoke two weeks ago and I agreed to send you over some details on the Committee's current membership and sponsorship, together with some ideas of the items which it may place on the agenda for its successor body to deal with. These are detailed in the attached papers. I should stress that the Committee has not yet discussed a formal agenda of items for its successor body, and I have drawn up the enclosed list purely on the basis of extracting information from the decisions taken at Committee meetings and recorded in the minutes. It could well be that the list is amended, and even enlarged, after the Committee have given the subject formal consideration at its meeting on 7 December 1994.
2. I have also written a short note which gives information on the research set in train by the current Committee, some of which will still be on-going when the successor body takes over.
3. Finally, there are three items on which the Committee made recommendations which involved amendments to the Companies Acts. These are that the Acts should be amended to come into line with the requirement of the Code that directors' service contracts should not exceed three years without shareholders' approval (paragraph 4.41); the disclosure of fees paid to audit firms for non-audit work (paragraph 5.12); and the question of the Government introducing legislation to extend to the auditors of all companies the statutory protection already available to auditors in the regulated sector (paragraph 5.28). You are probably aware that the DTI has set up several working parties to look at updating parts of the Companies Acts. I will be writing to Sarah Brown in Companies Division formally asking whether any of the above areas are likely to fall within their recommendations for change.

Please do let me know if you require any additional information.

I am sending a copy of this letter to Sir Adrian Cadbury for information.

With best wishes

Gina

Gina Cole
Secretary



Membership of the Committee

Sir Adrian Cadbury	Chairman
Jim Butler	Former Senior Partner, KPMG Peat Marwick (Former Council Member, ICAEW)
Jonathan Charkham	Former Adviser to the Governor of the Bank of England
Hugh Collum	Finance Director, SmithKline Beecham (Former Chairman, 100 Group of Finance Directors)
Andrew Likierman	Head of the Government Accountancy Service
Sir Sydney Lipworth*	Chairman, Financial Reporting Council
Nigel Macdonald	Partner, Ernst and Young (Former President, ICAS)
Mike Sandland	Former Chief Investment Manager, Norwich Union (Former Chairman, Institutional Shareholders Committee)
Mark Sheldon	Joint Senior Partner, Linklaters and Paines (Former President, Law Society)
Sir Andrew Hugh Smith	Former Chairman, London Stock Exchange
Martin Taylor**	Vice Chairman, Hanson plc (CBI)
Sir Dermot de Trafford	Former Chairman, Institute of Directors

Observers: Mrs Sarah Brown (from May - October 1991, and from August 1994 to date), Arthur Russell (November 1991 - August 1994) - Head of Companies Division, Department of Trade & Industry.

Secretary: Nigel Peace (May 1991 - December 1992)
Gina Cole (January 1993 - to date)

Sir Christopher Hogg acted as an adviser to the Committee prior to the publication of the Report and Code.

* Replaced Sir Ron Dearing with effect from 1 January 1994.

** Replaced Ian Butler with effect from April 1993.

Committee's Sponsorship

1. 1 June 1991 to 31 March 1993

Financial Sponsors - Stock Exchange
 - Financial Reporting Council
 - Big 8 Accountancy firms

Sponsorship in kind: - ICAEW
 (provision of office accommodation and
 secretarial support) - to end December 1992.

2. 1 April 1993 to 30 May 1995

Financial sponsors - Financial Reporting Council
 - Big 8 Accountancy firms
 - Institute of Directors
 - CBI

Sponsorship in kind - Stock Exchange
 (provision of accommodation, secretarial and support
 services) - from 1 January 1993.

2.1 It was agreed at a meeting between Sir Ron Dearing, Sir Adrian Cadbury and Nigel Peace in November 1992 that the sponsorship of the Committee should be extended to include the IOD, CBI and the ISC. In the event, the ISC declined to make a contribution.

2.2 Two approaches have been made to the sponsors listed in paragraph 2 above for financial support. The first, to cover the financial year April 1993 - March 1994 was for £8,000 from the IOD, CBI and FRC and £4,000 each from the accountancy firms. The same sums were requested for the period April 1994 to the end of the Committee's existence in May 1995. No further requests for funds are anticipated.

Research into Compliance with the Code

In order to take further the question of monitoring compliance with the Code of Best Practice, the Committee set up a Monitoring Sub-Committee, under the Chairmanship of Professor Andrew Likierman.

1. Computer Database

1.1 In conjunction with the Association of British Insurers, the Committee is financing a research project into levels of compliance by listed companies. A dedicated researcher has been appointed, partly funded by the Committee. The Committee's financial commitment has to date been £15,000 for each of the years September 1993 to August 1994 and September 1994 to August 1995. It has been made clear to the ABI that further funding beyond this date will be entirely dependent on the decisions made by the successor body.

1.2 The database contains details of levels of compliance of all the top 500 FT/SE companies, and a stratified sample of one in five of the remainder of listed companies. The first statistical report from this database will be submitted to the Monitoring Sub-Committee on 1 November 1994, and to the full Committee at the beginning of December.

2. ICAEW Corporate Governance Research Board

Both Professor Likierman and Gina Cole attended meetings of the Corporate Governance Research Group. The Group invited submissions from academics into research connected with corporate governance which would be of specific interest to the Committee and whose results would be available to the successor body when it was convened in mid-1995. The projects approved by the Group were:-

- 2.1 Board structures and Qualifications in Firms gaining quotation in the UK
- 2.2 The role of Institutional Shareholders in Corporate Governance.
- 2.3 Corporate Governance and Institutional Shareholders.
- 2.4 CEO Remuneration and Corporate Governance.
- 2.5 Corporate Governance, Internal Controls and the Management Audit.
- 2.6 Audit Committees in Small Listed Companies.

It is likely that a further meeting of the Group will be held early in 1995 to check on progress of the above projects. It may also be possible to enquire whether the ICAEW would be prepared to fund any further research into areas of interest to the Committee and its successor body.

3. Other Research

The Committee's Secretary has been monitoring research carried out by other organisations, (for example, Touche Ross, Coopers and Lybrand) and has copies of relevant reports.



Issues for the Committee's Successor Body

1. Paragraph 20 of the committee's Report, lists the following issues which the successor body "may wish to review or consider in greater depth":-

- (a) the application of the Code to smaller listed companies - paragraph 3.15. The Committee recognised that smaller companies may initially have difficulty in complying with some aspects of the Code and said that any practical issues which arose would be thoroughly reviewed by the Committee and its successor body.
- (b) Directors' training - paragraph 4.20. The new courses for directors mentioned in para/ 4.20 are now up and running and the current Committee will be able to report to its successor on their success.
- (c) the rules for disclosure of directors' remuneration, and the role which shareholders could play - paragraph 4.46.
- (d) a requirement for inclusion of cash flow information in interim reports - paragraph 4.56. This has been taken forward by the Institute of Chartered Accountants Financial Reporting Committee.
- (e) the procedures for putting forward resolutions at general meetings - paragraph 6.4.
- (f) developments regarding the nature and extent of auditors' liability - paragraph 5.35

2. In addition, the Committee has considered the following issues at meetings since the publication of the Report and Code, with agreement that they should be considered again by the successor body when it is convened.. The list is in no particular order of importance.

- (a) the wider issue of compliance with the spirit as opposed to the letter of the Code, and the reaction of the accountancy profession.
- (b) follow up by shareholders on non-compliance statements.
- (c) nomination committees to follow the same procedures in the appointment of both executive and non-executive

directors.

- (d) the length of directors' rolling contracts; specific disclosure of directors' notice periods.
- (e) directors' pay.
- (f) need for special provision for smaller companies discussed but not accepted by the Committee. Need to ensure that the guidance put out by CISCO (City Group for Smaller Companies) not used an "alternative" to the Code. Need for research into compliance levels of smaller companies?
- (g) Definition of executive/non-executive labels, number of non-executive directors on sub-committees. Confusion if Chairman is not explicitly non-executive.
- (h) extension of the Report and Code to large private companies.
- (i) the position of controlling shareholders and their effect on non-executive directors' tenure of office and independence.
- (j) need for the successor body to remain cognisant of the "overload" position.
- (k) need to reconsider the wording of paragraph 4.12 and the independence of non-executive directors.
- (l) four areas of possible further research were discussed and it was decided that perhaps a longer term view needed to be taken, these were:-

- directors' remuneration
- smaller companies' ability and willingness to comply
- availability and quality of non-executive directors
- role of shareholders at AGMs.

3. In addition to the above, Sir Sydney Lipworth is aware that the successor body will have to look again at the wording of paragraph 4.5 of the Code relating to internal control, in view of the fact that it appears likely that the guidance prepared by the accountancy profession will not insist on directors making a statement as to the effectiveness of the system of internal control, as at present specified in the Code.

4. When considering the work which its successor body would undertake, the Committee felt that it could be placed under three headings:-

(a) matters on which action is needed

(b) matters which have not been addressed by the Committee to date

and

(c) matters covered by the Code which should perhaps not be.