

CFACG(93)1st Meeting

COMMITTEE ON THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

The next meeting of the Committee will be held in the First Floor Committee Room at the Bank of England, Threadneedle Street, London EC2 on Wednesday, 3rd March 1993, beginning at 4.00 pm.

AGENDA

- ~~*~~ Apologies for absence
- ~~*~~ Arrangements for monitoring the Committee's recommendations and the Code of Best Practice (CFACG(93)1)
- ~~*~~ Guidance to companies on interpretation of the Report and Code (CFACG(93)2)
- ~~*~~ Any other business

Gina Cole
Secretary

23 February 1993

COMMITTEE ON THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

ARRANGEMENTS FOR MONITORING THE COMMITTEE'S RECOMMENDATIONS AND
THE CODE OF BEST PRACTICE

Note by the Secretary

BACKGROUND

1. At its meeting on 23 March 1992, the Committee discussed a proposal from the ICAEW Research Board to make funds available for research on corporate governance issues. There was agreement that research was necessary (although not necessarily all to be carried out by the Research Board), and that when the Committee's successor body was convened in 1995 they would require information on the effect of the Code. Details of the proposed ICAEW Research Board research are given at Annex I.

2. Paragraph 1.4 of the Report on the Financial Aspects of Corporate Governance states that "a programme of research will be undertaken to assist the future monitoring of the Code".

Monitored & audited .

Monitorable but not audited .

Questionable . .

Spirit .

Most Ok .

- Refusals

- Non-compliance statements

- Unease .

CORPORATE GOVERNANCE COMMITTEE

MONITORING SUB-COMMITTEE

3. In order to comply with the undertaking given in paragraph 1.4 of the Report, it is proposed that a Monitoring Sub-Committee be established. Professor Andrew Likierman has agreed to chair this sub-committee, and it is proposed that Sir Andrew Hugh Smith, Mike Sandland, Nigel Macdonald, Sir Dermot de Trafford and Ian Butler are asked to nominate representatives to sit on it (or to attend in person if they wish). Gina Cole will act as Secretary.

TERMS OF REFERENCE

4. The proposed terms of reference of the sub-committee are :-

4.1 To oversee the setting up of a system for collecting monitoring data on the extent to which listed companies comply with the Code.

4.2 To liaise with the ICAEW Research Board and other bodies interested in financing research into compliance with the Committee's recommendations.

FINANCE

5. Approximately £12,000 has been built into the amount requested from the Committee's sponsors to fund monitoring activities in the financial year 1993/94. Amounts for future years will be subject to the agreement of the sponsors.

POINTS TO BE CONSIDERED WHEN DECIDING ON MONITORING ARRANGEMENTS

6. The Committee may wish to bear in mind the following points:-

6.1 The minimum monitoring arrangement would comprise a straightforward YES/NO checklist, completed on scrutiny of companies' Report and Accounts for compliance with specified aspects of the Code, and entered into a database. A possible checklist for compliance is given at Annex II. The database could be established either by employing an extra member of staff, or by coming to an arrangement with another organisation undertaking similar monitoring (see paragraph 9 below). However, £12,000 may be insufficient to cover the costs of the former option - rough costings are set out in Annex III.

6.2 For research purposes, at least one year's data is required, so it will be end-1994 before a full year's

Report and Accounts have been published. More detailed research could involve in-depth studies of individual companies. The number of companies looked at could, for example, be limited by stratified sampling, rather than limiting the amount of information obtained.

6.3 The compilation of a comprehensive database including approximately 1000 companies would be in the region of £50,000. Consideration could also be given to the establishment of a related database to monitor companies' progress on the Committee's recommendations on interim reporting.

6.4 Is there merit in investigating whether the spirit of the Code has been kept as well as the letter?

ACTION

7. The Committee is invited

7.1 to decide what information it considers its successor body will need to evaluate compliance with the Code when it is convened in 1995;

7.2 to consider whether they are content with the implications of its funding requirements and to decide on any action they wish to take;

7.3 to agree the membership of the sub-committee to deal with the monitoring, and its terms of reference;

7.4 to decide whether they wish to propose additional members to sit on the ICAEW Research Board sub-committee.

8. When the Committee has decided on the extent of its monitoring role:

8.1 the ICAEW Research Board committee can consider whether this is adequate for its requirements (ie whether it will be extensive enough a base for meaningful research);

8.2 the most cost-effective method of providing the database can be explored by either the Sub-Committee and/or the ICAEW Research Board sub-committee.

OTHER ORGANISATIONS MONITORING COMPLIANCE WITH THE CODE

9. Other organisations known to be currently monitoring corporate governance issues, and with whom some form of partnership could be explored, include:-

9.1 ABI (Association of British Insurers)

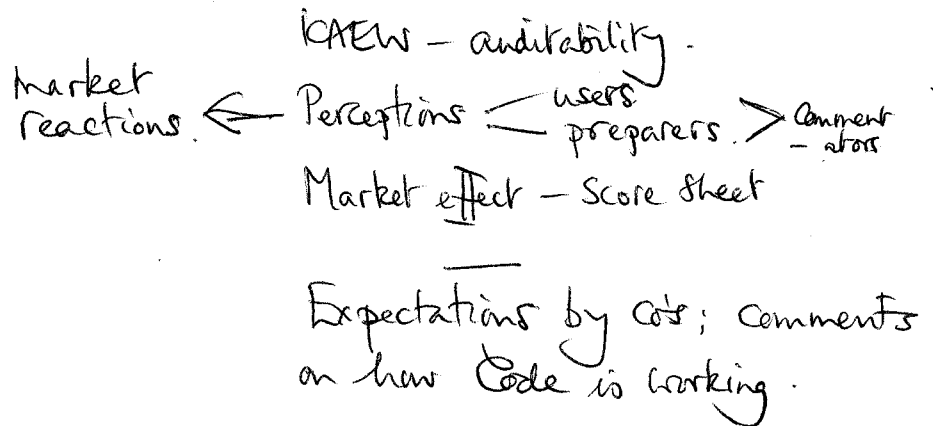
The ABI have purchased a single share in almost 1000 listed companies with the aim of monitoring their annual reports.

9.2 NAPF (National Association of Pension Funds)

NAPF carry out a monitoring service on a subscription basis and currently cover approx. 150 listed companies (they hope to increase this to 350).

9.3 PIRC (Pensions Investment Research Consultants)

PIRC's Corporate Governance Monitoring Service currently covers the FTSE 100 companies.



THE ICAEW RESEARCH BOARD

1. In May 1992 it was agreed that a committee should be set up to oversee a research programme on corporate governance, with the following terms of reference:-

1.1 to identify areas in which research projects should be invited, the constituencies from which applications should be sought and when projects should be undertaken;

1.2 to select those projects which should be recommended to the Research Board for funding, taking advice from external referees where appropriate;

1.3 to determine the form in which the results of the research undertaken should be disseminated, again after advice from external referees where appropriate.

2. It would not be within the remit of this committee to be responsible for the overall function of monitoring the implementation of the Code of Best Practice.

RESEARCH AREAS

3. Two broad areas in which research might be invited were agreed:-

- 3.1 Compliance with the Committee's proposals (eg studies of the characteristics of companies which might explain why some comply with some or all of them and others do not; studies to investigate whether compliance is real as opposed to cosmetic; and studies of the economic consequences of compliance - ie does compliance have effects on management behaviour, share price, etc?)
- 3.2 Research concerned with other aspects of corporate governance not addressed directly in the Committee's Report, (eg the effects of the single market on corporate governance).

MEMBERSHIP

4. It is likely that the membership of the committee would include:

Brian Worth - Chairman of the Research Board

Professor Andrew Likierman - on behalf of the Committee
on Corporate Governance

Professor John Arnold - Director of Research ICAEW

Professor Len Skerratt - Chairman of Research Board's
Database Group

Ruth Cooke - ICAEW

A Research Board member with institutional shareholder
experience

An auditing specialist

Gina Cole (as an observer)

TIMETABLE

5. In view of the fact that the date for review of the implementation of the Cadbury Committee proposals is June 1995, the target date for the completion of projects (in order to allow time for refereeing and dissemination) should be early in 1995. To meet this date, applications would have to be submitted by June 1993, and projects would need to commence between September 1993 and January 1994.

POSSIBLE CHECKLIST OF POINTS FOR COMPLIANCE

To be found in the Recommendations

Para No:	Summary:
2	Statement of compliance.
8	Disclosure of fees for non-audit work.
10	Effectiveness of internal control systems.
11	Directors' statement on going concern.
16.	Institutional investors to disclose policies on voting rights.

To be found in the Code

Para No:	Summary:
1.2	Responsibilities of Chairman/Chief Executive.
1.3	Number and calibre of non-executive directors.
3.2	Disclosure of directors' emoluments.
4.1	Balanced and understandable assessment of company's position.
4.3	Audit Committee.
4.4	Directors' responsibilities.

4.5 Effectiveness of internal control.

4.6 Business a going concern.

All the above points can be monitored and data entered into a database. The question arises however as to whether just the minimum amount of information should be recorded (in some cases this will be a straightforward YES/NO answer), or more detailed information allowing for wider subsequent research by the Committee, the ICAEW Research Board or any other interested body.

There may also be merit in collecting data outside the remit of the Code.

Annex III

MONITORING TIMES

An experienced employee of the NAPF estimates that it takes him about 45 minutes to scrutinise a company's Annual Report and Accounts to extract information for their database. The following calculations use an hour (to allow for relative inexperience) and presuppose a 35 hour working week in a 46 week working year.

- to monitor 2000 reports @ 1 hour each in a 35 hr/week would take a total of 57 weeks (ie over a year)

- to monitor 500 reports on the same basis would take 14 weeks

- in 46 working weeks of 35 hours each a total of 1610 reports could be monitored

General consultation 'no'
Basis of experience indicate areas
where might give more guidance.

CFACG(93)2

Advice.
Not nec. right body
Interpretation of what
is intended.
Monitoring but throw up
issues.

Committee on the Financial Aspects of
Corporate Governance

**ENQUIRIES FROM COMPANIES SEEKING GUIDANCE ON INTERPRETATION OF
THE REPORT AND CODE OF BEST PRACTICE**

What areas. etc. be envisaged in which
Conflicts. Note by the Secretary

Boards Consideration

BACKGROUND

Connected persons.
Disclose.

Personal - fees / shldg.

Corporate - what potential
Conflicts of Interest em. / adv.
relationship / materiality test

1. The publication of the Report on 1 December has generated a number of enquiries from companies seeking guidance on interpretation of recommendations made in the Committee's Report and the Code of Best Practice. These enquiries have ranged from the very straightforward (eg "Is the Stock Exchange really going to make compliance with the Code a listing requirement?") to the more complicated.

Disclosure..

2. Examples of some of the more detailed written queries are attached. These can be summarised as follows:-

Independence of Directors - Brixton Estate plc

2.1 Mr Axton, the Chairman of Brixton Estate, seeks guidance on the definition of independence regarding non-executive directors (paragraph 4.12 of the Report refers). Two of the company's

directors are also Chairmen of insurance companies which have shareholdings in Brixton Estate. Does this affect their "independence"?

2.2 Other organisations which have raised the question of independence include Hambros plc, Lloyds Bank, Guinness Mahon and the British Bankers Association. Copies of relevant correspondence are attached.

Nomination Committees - Norton Rose

2.3 Queries regarding the constitution of nomination committees and an apparent anomaly in guidance:-

- (a) Para 4.30 of the Report states that a nomination committee would be responsible for proposing to the board both executive and non-executive directors, but para 2.4 of the Code refers only to non-executive directors. Norton Rose consider that this could lead those who refer only to the Code (and not the full Report) to infer that the nomination committee should only deal with non-executive appointments, which is presumably not the Committee's intention.
- (b) The Committee should consider whether future editions of the Code should state that the question of whether a Nomination Committee is appointed on a standing or ad hoc basis is at the discretion of the Board.

Length of Directors' Contracts - Hugh Collum

2.4 Clarification on interpretation of the Code in relation to Directors' service contracts not exceeding three years without shareholders' approval.

Directors Seeking Independent Advice - Dundas & Wilson

2.5 Are the Committee proposing to issue guidance on the procedure to be adopted when directors seek independent professional advice? (para 1.5 of the Code and para 4.18 of the Report refer).

ACTION

3. The Committee is invited to discuss the above questions of interpretation, and also to consider the need for firm guidance to be given in these and other questions of interpretation. If it is not, will the Code become meaningless? Alternatively, the writing of detailed guidance etc. and evolution of a large bureaucracy to advise on interpretation would be expensive to maintain.

BRIXTON ESTATE plc

DIRECTORS:

HENRY S. AXTON, F.C.A. CHAIRMAN
SIR DOUGLAS MORPETH, T.D., F.C.A. DEPUTY CHAIRMAN
DOUGLAS F. GARDNER, F.R.I.C.S. MANAGING DIRECTOR

SIR RICHARD BAKER WILBRAHAM, Bt., D.L.

MARSHAL OF THE ROYAL AIR FORCE SIR MICHAEL BEETHAM, G.C.B., C.B.E., D.F.C., A.F.C., D.L.

STEVEN J. OWEN, F.C.A.

SIR JOHN CUCKNEY

TERENCE J. NAGLE, F.R.I.C.S.
DAVID E. MARLOW, F.C.A.

Registered Office:

22 - 24, ELY PLACE
LONDON
EC1N 6TQ

Registered in England No. 202342

Your Ref:

Our Ref:

HSA/TBF/BE

22 December 1992

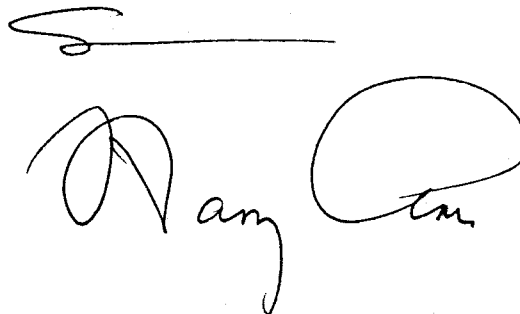
Sir Adrian Cadbury
Committee on The Financial Aspects
of Corporate Governance
P O Box 433
Moorgate Place
LONDON
EC2P 2BJ

Dear Sir Adrian

Thank you for your letter dated 10 December and your guidance in connection with "independent" non-executive directors.

You may be interested to know that at its meeting on 15 December the Board was firmly of the opinion that the two individuals to whom I referred in my letter of 4 December were "independent". On the other hand, one of them considered that he himself was not "independent".

My feeling is that any further guidance that the Committee could give would be welcome.



H S AXTON
Chairman

COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

10th December 1992

PO Box 433
Moorgate Place
London EC2P 2BJ
Tel: 071-628 7060 ext 2565
Fax: 071-628 1874

Mr Henry Axton FCA
Chairman
Brixton Estate plc
22-24 Ely Place
London EC1N 6TQ

Dear Mr Axton,

Nigel Peace has shown me your letter of 4 December. I am grateful to you for writing.

The Code states at 2.2 that the majority of non-executive directors should be 'independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement, apart from their fees and shareholding.' Note 4 says that it is for the board to decide whether this definition of independence is met, and that information about the relevant interests of directors should be disclosed in the annual report.

The reason why in the end boards have to be responsible for reaching their own conclusions on these matters is that every case will be different. Even though the Code says 'apart from their fees and shareholding', an individual shareholding could be sufficiently large to make it difficult for the director concerned to separate his own interests from those of the company. But this is not a judgement that could be made against a set scale of shareholding levels.

While the independence of someone who was a large shareholder in his own right could be called into question on the basis that he might be more inclined to act in his own interests, rather than those of the shareholders generally or of the company as a whole, slightly different considerations apply where the connection is that the director concerned is on the board of a major shareholder.

In my view, relevant questions then would be the nature of the relationship between the two boards, whether the shareholding company had rights of nomination, how important the investment was to the shareholding company and the standing of the directors involved. My guess on the information contained in your letter would be that, on those kinds of grounds, you would have a good case for counting your two shareholding directors as independent, but that is a decision which can only be made by your board.

If your board concludes that the precise nature of the connection with the shareholding companies and the qualities of the individual directors concerned are such that it has no reservations about their independence, then I believe that there is no conflict with the spirit of the Code. However, it would be essential for the connection to be fully disclosed in the annual report so that shareholders could draw their own conclusions.

I would be very happy to raise this issue with the Committee when we next meet, at the beginning of March, and to consider whether we should attempt to provide more definite guidance. In the meantime, I am simply giving you my personal reaction to the question which you have posed.

Yours sincerely

Adrian Cadbury

Adrian Cadbury
Chairman

BRIXTON ESTATE plc

DIRECTORS:

HENRY S. AXTON, F.C.A. CHAIRMAN
SIR DOUGLAS MORPETH, T.D., F.C.A. DEPUTY CHAIRMAN
DOUGLAS F. GARDNER, F.R.I.C.S. MANAGING DIRECTOR

SIR RICHARD BAKER WILBRAHAM, Bt., D.L.
MARSHAL OF THE ROYAL AIR FORCE
STEVEN J. OWEN, F.C.A.

SIR JOHN CUCKNEY
TERENCE J. NAGLE, F.R.I.C.S.

Registered Office:
22 - 24, ELY PLACE
LONDON
ECIN 6TQ

Registered in England No. 202342

Your Ref:

Our Ref:

HSA/TBF/BE

4 December 1992

Mr Nigel Peace
Secretary to the Committee on the
Financial Aspects of Corporate
Governance
P O Box 433
Moorgate Place
LONDON
EC2P 2BJ

Dear Mr Peace,

Further to our telephone conversation I wonder if you would consult the appropriate member of the Committee with a view to clarifying the following problem arising from your recently published report.

In the report, the Committee makes the following recommendation regarding Audit Committees:

"There should be a minimum of three members. Membership should be confined to the non-executive directors of the company and a majority of the non-executives serving on the committee should be independent, as defined in paragraph 4.12 above. Membership of the committee should be disclosed in the annual report."

The problem which I discussed with you was the meaning of the word "independent" for this purpose. Brixton Estate's shares are owned 23% by Clerical Medical & General and 18% by Royal Insurance. The tradition over a number of years has been to invite the chairmen of each of these companies to become members of the Brixton board of directors. There is no right of nomination by either of the shareholders concerned and there is no obligation on the Brixton board to continue the arrangement, although in practice it has proved

... cont

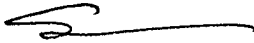

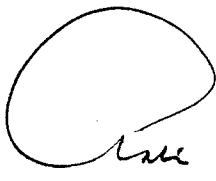
4 December 1992

Page 2

to be extremely helpful. The only business connection between the respective companies, other than the shareholdings, is that Clerical Medical & General insures the company's pension scheme.

Arrangements of this sort must apply to many other companies and it would be very useful to have the official view of your Committee on whether these two directors should be counted for the purposes of "independent" directors or not. I should say that in practice both of the individuals concerned are meticulous in behaving in an independent capacity.

We have a Board meeting on Tuesday 15 December at which this question will arise, and I should be grateful for your guidance.

H S AXTON
Chairman