

COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

COPY

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15 December 1993

To all Committee Members

Committee Meeting 24 November 1993

Please find attached a copy of the minutes of the above meeting. Further to the discussion recorded under Agenda Item 5, Sir Adrian wrote to Bill Morrison at the APB and in similar terms to the Secretaries of the Working Groups on Going Concern, Internal Control and Interim Reporting. A copy of the letter is attached for information.

The guidance on going concern and internal control was the subject of discussion at the latest "overload" meeting which Sir Adrian attended on Monday 13 December. Subject to Sir Ron Dearing's agreement, I will circulate the minutes of that meeting as they become available to keep you informed of developments.

Finally, I am enclosing a photocopy of a small survey carried out amongst West Midlands companies by Price Waterhouse, which you may find of interest.



Gina Cole
Secretary

COMMITTEE ON THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

MINUTES OF THE MEETING HELD ON WEDNESDAY 24 NOVEMBER 1993
AT THE BANK OF ENGLAND

Present: Sir Adrian Cadbury
Jim Butler
Jonathan Charkham
Hugh Collum
Sir Dermot de Trafford
Andrew Likierman
Arthur Russell
Mike Sandland
Mark Sheldon
Martin Taylor
Gina Cole

Agenda Item 1

1. Apologies for absence were received from Sir Ron Dearing, Sir Andrew Hugh Smith and Nigel Macdonald.

Agenda Item 2

2. The minutes of the previous meeting on 9 September 1993 were agreed.

Agenda Item 3 - Extension of the Report to Large Private Companies

3. Jonathan Charkham introduced his paper on the extension of the Committee's Report to large private companies by agreeing that the subject was outside the current Committee's terms of reference, but he suggested that it could be considered for inclusion on the agenda for the successor body in 1995.

4. The rationale behind the paper was that the division of companies into quoted and unquoted companies should be changed so that a company's accountability should not just depend on quotation, but rather on its size and its consequent potential effect for damage or benefit to society. He was not advocating the adoption of the German two-tier board system, but felt that changes could be made within the existing UK system of corporate governance.

5. Secondly, the paper addressed the question of tenure and position of non-executive directors, and suggested that the current UK law may need to be changed to bring unquoted companies more in line with the obligations on quoted companies, and by extension of the Code of Best practice to cover large private companies. Sir Dermot de Trafford pointed out that the only way of policing private companies is through the law, although he agreed with Mike Sandland that they could be subject to a voluntary code of conduct. Martin Taylor added that although governance was not currently an issue in private companies, the position could well change in due course. Mike Sandland said that the public resignation of a non-executive director alerted shareholders to problems within the company.

6. The Chairman drew attention to the section in the recently published survey by Coopers and Lybrand into the attitudes of medium-sized companies towards the Code which focused on the issue of the major shareholder, and power based on shareholding as well as position in the company. He summed up by saying that both this issue, and that of the extension of the Report to private companies could be taken further by the Committee's successor body.

Agenda Item 4 - Monitoring Sub-Committee Progress Report

7. The Chairman of the Sub-Committee, Andrew Likierman, advised that he wished to make only one comment in addition to the progress report already circulated. Some outline research proposals had been submitted which looked initially very interesting, but had been rejected by the Research Board Sub-Committee as being unresearchable. Those researchers who had been asked to submit fuller proposals, were considered by the sub-committee as having a reasonable chance of acquiring the information they needed to carry out meaningful work.

Agenda Item 5 - Progress on guidance on Going Concern

8. The Chairman read out a letter he had received from Sir Ron Dearing in which he confirmed that the APB were going to "re-expose" their proposals on going concern. Jim Butler confirmed that the issue was still unresolved within the APB. The Chairman considered that there was an issue of principle for the Committee, in that the Committee asked for guidance to be developed on certain issues in order that companies should know what was expected of them when complying with the Code of Best Practice. Understandably, when issues have been looked at they have become broader than the original recommendation in the Report. The question arises as to what extent it might be possible to split guidance being prepared into that part which relates to the specific issues raised by the Committee, and the wider issues arising. This corresponds to the suggestion made by Nigel Macdonald in his letter of 24 November circulated to Committee members, that the guidance should be confined to a statement of basic principles.

9. The second point of principle concerned the nature of the Committee's authority. Recommendations are being made to the Committee for endorsement whereas the Chairman felt that this was not the Committee's job.

10. The Committee then discussed the merits of the lines taken by the APB and the ICAEW Working Group on the going concern statement, and the expectations of an informed reader of accounts. Martin Taylor pointed out that the potential costs to a company should be taken into account, and the Chairman was concerned lest companies should be given guidance which would be burdensome and difficult to comply with. Mark Sheldon put forward the view that it was not up to the Committee to make a decision between the two views. He was concerned to ensure that the Committee's proposals remained practicable, otherwise its support would be lessened. To date the Committee's approach, which had proved successful, had been based on three tenets (a) it was practical, (b) it was a gradual process, and (c) it carried support. This support could be lost if the Committee became too ambitious. This view was supported by Mike Sandland.

11. The Chairman agreed that the Committee should not make a decision between the two sets of proposed guidance, but he would get in touch with both Bill Morrison at the APB and Sir Ron Dearing in an effort to get the two parties to resolve the issue.

12. Hugh Collum reported that the 100 Group of Finance Directors had discussed the "overload" question and had welcomed the revised guidance timetable. However, concern remained amongst the Group on the proposed internal control guidance. The Chairman referred to Nigel Macdonald's letter (see paragraph 8 above), and Hugh Collum agreed with the suggestion in it that the guidance should be reduced in size and limited to the financial aspects of internal control. Mike Sandland supported the Chairman's view that the Committee should promote the concept of a set of key principles. The Chairman agreed to discuss this further with Bill Morrison and to add that the Committee did not consider itself qualified to authorise any guidance. He would also contact Clive Letchford at the ICAEW and inform him of the action the Committee was taking, he would request that the ICAEW did not publish its letter to the Chairman concerning the Going Concern guidance, and reiterate that the Committee was not in the position of endorsing guidance.

Agenda Item 6 - Law Society Guidance

13. Jim Butler advised that there was shortly to be a meeting between the APB and the Law Society to discuss the guidance on the Directors' Statement in the Report and Accounts. The Committee agreed with Mark Sheldon's proposal that the discussion should take place without comment from the Committee, who should only take appropriate action should the two parties fail to reach agreement.

Agenda Item 7 - Any Other Business

14. The Chairman referred to the survey carried out by Coopers and Lybrand into medium-sized firms' reaction to the Code, previously circulated to Committee members. He considered that the points made were reasonable, and drew attention to the section which addressed the position of major shareholders. There was some discussion on the point made in the survey that some companies felt there was a stigma attached to making a statement of non-compliance. Mark Sheldon considered that it would be very undesirable if a situation arose where it was acceptable for companies in the Top 200 to persistently make non-compliance statements. The Chairman's view was that non-compliance would mainly centre on the number of non-executive directors. Jonathan Charkham added that nothing had occurred which made him think that the Committee was wrong in its decision to include small companies in the need to make a compliance statement, even though it may take them more time to comply fully. He added that the sampling carried out by the ABI as part of its monitoring would show up any problems of non-compliance in smaller companies in due course.

15. Mark Sheldon drew attention to developments on corporate governance in Canada and the visit to the UK of the Chair of the Toronto Stock Exchange's Committee on Corporate Governance. One concern in Canada was the apparent large number of non-executives on boards and the question of their competence.

16. The draft APB Bulletin which contained advice on the drafting of the auditors' review of the statement of compliance was briefly discussed. The Committee were in agreement with Jim Butler's opinion that it was consistent with the Committee's views.

Agenda Item 8

17. The next meeting of the Committee will be on Wednesday 23 February 1994 at the Bank of England, commencing at 4.15 pm.

Gina Cole
Secretary
14 December 1993

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Bill Morrison
Auditing Practices Board
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9th December 1993

Dear Bill,

The Committee turned to the accountancy profession for guidance on a number of issues, notably in respect of internal control and going concern. We are grateful for the attention which the appropriate professional bodies have given to these two matters. The discussion drafts on them which have recently been published do, however, go wider than the points raised by the committee. It, therefore, seemed timely to set down the relationship, as the committee sees it, between its own recommendations and those of the bodies to which the committee has referred matters which were outside its scope.

First, there is the question of the authority under which guidance is to be issued on internal control and going concern. This has to be on the authority of the body which prepares the guidance. The committee is not qualified to endorse accounting or auditing proposals, nor to publish them. It will give all the help it can in their preparation and will send in comments when asked to do so.

Second, it maybe helpful to define as precisely as possible the kind of guidance which the committee is looking for from the accounting and auditing bodies. The overall aim is to win acceptance by boards of the committee's recommendations. This suggests that guidance could best be framed along the same lines as the committee's Code of Best Practice. The characteristics of the Code are that:-

It is based on statements of principle.

It is brief - the Code is two pages backed by four pages of notes.

Its recommendations can be met by well-run companies without requiring them to devote significant additional resources to compliance.

In addition, it would be helpful to the committee and to companies if the guidance was limited to the particular issues over which advice had been sought by the committee. One way of doing this would be to split, for example, the drafts on internal control and going concern into two. the first document would consist of a

very brief statement of principles directed solely to the issues on which the Committee had sought guidance. There would then be a longer document covering related matters, plus working examples and other material.

It is essential that the guidance on the implementation of the committee's recommendations should be as straightforward, practical and as cost effective as possible. Compliance with the Code depends largely on boards of directors accepting that its proposals are sensible and can be implemented without unnecessary administrative expense.

The Committee's authority derives from the bodies which set it up and the perception by boards and their shareholders that its proposals strike a reasonable balance between costs and benefits. If that balance was not being seen to be held over any one of the Committee's recommendations, the support of the corporate sector for the rest of the Committee's recommendations could be at risk.

If it would help to discuss these points in more detail, Sir Ron Dearing and I would be glad to meet you for that purpose.

I am sending copies of this letter to Michael Chamberlain (CCAB) Michael Lawrence (100 Group of Finance Directors) and Allan Cook (ASB)

Yours sincerely
Allan

Adrian Cadbury
Chairman

CORPORATE GOVERNANCE
Implementing the Recommendations of the Cadbury Committee
in the West Midlands

This paper reports the results of a survey undertaken by Libre Marketing (Research Division) on behalf of Price Waterhouse during October 1993. The findings reported are based upon a survey sent to 127 public companies in the West Midlands region; replies were received from 30%. The sample included both fully quoted and USM companies.

The survey focused primarily on issues of Board and Committee Structure, Interim Reporting and Rotation of Auditors.

BOARD STRUCTURE

Cadbury expressed concern over the potential risks from "a considerable concentration of power" if the roles of Chairman and Chief Executive are combined. He also recommended that Boards should have Non-Executives of "sufficient calibre and number" (at least three) to carry weight in the Board decision making processes.

This survey finds that:

- Almost one-third (30%) of West Midlands plcs have a combined Chairman and Chief Executive at the head. However, this is down from the 40% level of a year ago. More fully quoted companies have separated these roles than USM/junior market organisations.
- Half the Region's plcs now have 3 or more Non-Executive Directors and in 15% of companies they outnumber Executive Directors.

It was also recommended by Cadbury that Directors' service contracts should not normally exceed three years.

This survey finds that:

- 87% of West Midlands' Directors have service contracts. Only 19% of companies have granted service contracts which exceed 3 years.
- There is also evidence to suggest that such contracts are rarely granted to Non-Executives.
- Service contracts would also appear to be less prevalent amongst smaller and USM/junior market companies.



AUDIT AND REMUNERATION COMMITTEES

Cadbury recommended that "all Listed Companies should have a formally constituted Audit Committee"

This survey finds that:

- Over three-quarters (78%) of West Midlands plcs have such an Audit Committee
- Amongst fully quoted companies this figure rises to 84% but amongst USM/junior market companies it is only 50%.

There has been much recent press commentary regarding remuneration levels and pay awards granted to Company Directors, particularly those of more prominent companies. Cadbury recommended that Boards should "appoint a Remuneration Committee consisting wholly or mainly of Non-Executive Directors" and that "Executive Directors should play no part in decisions on their own remuneration".

This survey finds that:

- 84% of West Midlands plcs have a Remuneration Committee. This is well up on the 69% in pre-Cadbury days.
- Those 16% who have no Remuneration Committee, coming largely from amongst USM/junior market companies, nearly all also lack an Audit Committee.
- Remuneration Committees rarely have more than one Executive Director and are always well outnumbered by Non-Executives.

INTERIM REPORTING

Cadbury suggested that the "guiding principle" of financial reporting should be "openness and fairness". The Committee recommended that balance sheet information should be included in Interim Reports and that consideration should be given to cash flow statements. Cadbury also suggested that statements should be reviewed and discussed with the auditors.

This survey finds that:

- Only half of companies include a balance sheet and less than 15% a cash flow statement. Fully quoted plcs are more likely to include these statements in their Interim Reports.
- Just under half (47%) are reviewed by the auditors; again more frequently so amongst fully quoted plcs.

AUDIT ROTATION

Although Cadbury made no specific recommendation regarding Audit Rotation, it is an issue for the accountancy profession.

This survey finds that:

- West Midlands plcs reject formal/statutory Audit Rotation by a majority of five to one.

CONCLUSIONS

Overall, it is clear that West Midlands business has taken Cadbury on board.

Whilst a clear majority of companies have separated the role of Chairman and Chief Executive there is a substantial minority of companies where the roles are combined. This may just be a matter of timing but it possibly also reflects a strong minority view that the roles do not have to be separated. Half of the companies still need to recruit more Non-Executive Directors to comply with Cadbury.

The existence of Audit and Remuneration Committees is no surprise and their compositions appear, for the most part, fairly healthy. In the wake of Cadbury and press comment there seems to have been a significant increase in these Committees.

It is disappointing to see relatively few plcs publishing more comprehensive Interim Reports; if cash really is King, shareholders will surely wish to see a balance sheet and a cash flow statement more frequently.

Finally, it is also no surprise to see business voting against Audit Rotation. The audit relationship is built on stability and trust; frequent rotation would enhance the prospects for fraud, not curtail it.

The statements made in this report are intended to faithfully reflect the findings of the survey. No responsibility for error or misinterpretation is accepted by Libre Marketing or Price Waterhouse.

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

Extension of the Report's recommendations to large private companies

Article by Jonathan Charkham which first appeared in the August edition of "Governance" magazine.

"The Cadbury Committee was concerned mainly with quoted companies - quite properly so since the Stock Exchange was one of its sponsors and so much of the UK's business is conducted by them (a much higher proportion than in Germany and Japan). The Report (para 3.1) did however state "We would encourage as many other companies as possible to aim at meeting its (the code's) requirements". There are indeed some important issues to be considered about the governance of unquoted companies.

Although such companies are technically private property, they have public effects both in prosperity and failure. The nature of the market system is to accept the risk of failure as part of the price of progress: growth may often reduce that risk but it always increases its consequences. The closure of the corner shop can marginally inconvenience its neighbours; the bankruptcy of a major employer can devastate a town.

Any business may fail. But the bigger a business becomes the greater the obligation of the directors to all who depend upon it, employees, customers, suppliers and neighbours, as well as shareholders, not to fail needlessly. The larger it grows the more is staked on the competence of its directors and the greater the need for a governance system which helps it maintain its standards. We can express this in terms of accountability by saying that the bigger a business gets the greater the accountability of management should be: the degree of accountability should not just depend upon whether a company is quoted or not, but also on its size and its consequent potential effect upon society.

At the present time UK does not accept this proposition. True, there are obligations on directors of quoted companies which do not extend to private companies, but no company need have more than two directors (Companies Act 1985, Table A, Sec. 64), nor a board. The law only recognises one class of director. The Cadbury Committee (1993) inter alia requires all quoted companies to have some directors to have no executive duties and indeed to be independent and it proposes that it is they who should constitute audit and remuneration committees. It further requires that boards that meet regularly and have certain decisions reserved to them. But the Cadbury Committee's remit does not extend to unquoted companies whatever their size.

The Germans have long taken a different view. An unquoted company (GMBH) must nevertheless have a supervisory board with employees constituting a third of it. The purpose of such arrangements is not just to give the workforce its say, but to ensure a proper process. This cannot in itself ensure success, but its benefits should not be overlooked. It means regular (though not necessarily frequent) board meetings and having to prepare proper proposals. It means more light in dark corners. It creates, however imperfectly, a system of accountability.

If we accept the idea in principle that the process of governance should reflect in some way the increases capacity of a company to inflict damage through inefficiency or avoidable demise, the instrument in the UK model which needs adapting is our unitary board. The UK tradition would seem to rule out a two tier system; and there is little current support for employee representation.

The logical approach would therefore be to extend the Cadbury Code to big companies - say those with more than 500 employees in the group. This would mean their having non-executive directors and audit committees. It would also oblige them to have meaningful reports and accounts in which among other things the background of the non-executive directors would be described, and their role in the company's governance.

As the power of appointment of directors would still rest with the shareholders, whose representatives would in many cases dominate the board, the whole exercise might appear to be pointless. Stoooges, it is argued, would be chosen, to be used at random and dismissed at will. But it is not as simple as that. The background of the directors would be stated and could be ascertained by anyone interested in the company. Their dismissal or resignation could become matters of public interest. Perhaps their independence could be buttressed by securing them against capricious dismissal, which might require a super majority of say 75% of the shares. [A fortiori there is a case for such a requirement for quoted companies to cover cases a' la Maxwell where there is a majority shareholder (or shareholding group) on the board.] Such a system would be far from perfect but it would be better than what we have now. It would moreover strengthen private company boards in a more constructive way by bringing on to them outsiders who, if sensibly chosen, could supplement existing skills.

I do not contend that there is a case for extending the Cadbury Code to small private companies, even though they too would often find non-executive directors useful. Small businesses are typically rich in some skills and poor in others; suitable NEDs can often provide the necessary balance or make sure it is obtained. They are an inexpensive way of getting not just advice from people committed to the company and it is commitment that lies at the very heart of the private company. But commitment and motivation, though necessary, are not sufficient. Motivation without competence is probably even less productive than competence without motivation.

The modest proposals in this article address the issue of continuing competence in significant companies. We all know that in the short term it is possible to get away with any kind of governance system. If we want sustained progress a good governance system will help achieve it, though nothing ensures success for ever."

**COMMITTEE ON THE FINANCIAL ASPECTS
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Progress Report from the Monitoring Sub-Committee

Background

1. The Monitoring Sub-Committee, under the Chairmanship of Professor Andrew Likierman, has met four times during the year. It has established, in conjunction with the Association of British Insurers, a system for monitoring compliance statements made by listed companies; it is liaising with the ICAEW Research Board on research projects into corporate governance funded by the ICAEW, and discusses possible future areas for research.

ABI Monitoring

2. John Weld, the researcher appointed by the ABI to carry out the monitoring research, addressed the Monitoring Sub-Committee at its meeting on 17 November. He advised that only a handful of annual reports with year ends after 30 June 1993 had been received. Of these, he had followed up a few minor points with the company secretaries concerned on the phone and had generally received a very positive response.

3. He was most disturbed by the fact that none of the reports received had published the report by the auditors on the compliance statement. Furthermore, he had heard through an unofficial channel that the APB was about to publish a Bulletin to the profession in which three options were suggested as courses of action:-

- (a) for the auditors to report separately (as had been envisaged in the Committee's Report);
- (b) for the auditors to comment in the report only on some aspects;
- (b) to rely solely on the Directors' Report.

[4. After the meeting, the Secretary contacted the APB and was advised that a Bulletin had been drafted and was almost ready for issue. It was awaiting one or two amendments before final approval by the Board. It was agreed that a copy would be sent to the Committee as soon as possible, as the Secretary stressed that the Committee would like the opportunity to discuss it at its meeting on 24 November, and comment on it if necessary. She was assured that it would not be published prior to the Committee's meeting, but the APB were reluctant to agree to the possibility of the Committee making any changes to what at that stage would be an agreed final draft.]

5. The Committee has now contributed £15,000 towards the cost of the ABI researcher for the year September 1993 - August 1994. It has been made clear that funding beyond that point will be dependent on the Committee receiving continued sponsorship.

ICAEW Research

6. The ICAEW Research Board Corporate Governance Research Group met on 29 September to consider outline proposals for research into corporate governance issues, in response to an invitation issued by the Research Group. Nine projects were accepted, and the researchers were invited to submit detailed proposals for consideration by the Committee on 14 December. The projects fell into the following five broad categories:

1.	Modus operandi of the board	1 project
2.	Non-executive directors	2 projects
3.	Role of institutional shareholders	2 projects
4.	Remuneration packages and issues in executive pay	2 projects
5.	Other	2 projects.

The Secretary to the Corporate Governance Research Group has indicated that she has made a bid for funds for further research projects in 1994.

Other Areas for Research

7. The Sub-Committee are keeping under review any areas worthy of further investigation, especially with regard to any trends which may emerge from the ABI monitoring exercise in due course.

Gina Cole
18 November 1993

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

Timetable for "Going Concern" and other guidance

Going concern

1. The draft guidance for directors on going concern was issued in May, and it was intended that the final guidance should be put before the Committee at its meeting on 24 November. However, it transpired at a meeting of the APB on 16 November, that there was a difference of opinion between the working group preparing the guidance for directors and the APB working group preparing guidance for auditors on the length of time into the future which the "going concern" statement should cover.

2. It appears that the ICAEW working group is standing by its draft and has no intention to alter it at the present time, but that the APB intend to invite further comment by issuing a re-exposure draft. Both working parties have advised the Secretary that they intend to write to Sir Adrian Cadbury to update him on the position. I will circulate copies of these letters if they are received prior to the meeting.

"Overload" meeting

3. Attached are copies of the minutes of the "overload" meeting on 14 September. After this meeting, an agreed press statement was released, which set out the future timetable for the issuing of guidance, and copies were circulated to Committee members.

4. You may wish to discuss the implications for the Committee of the matters discussed at the 14 September and decide whether there are any issues which the Committee should suggest for the overload group's next meeting, which is scheduled for 13 December.

Gina Cole
18 November 1993

FINANCIAL REPORTING AND CORPORATE GOVERNANCE 'OVERLOAD'

Note of a Meeting held on 14 September 1993 at the offices of the
Financial Reporting Council, 100 Gray's Inn Road, London WC1

PRESENT:

Sir Ron Dearing	Chairman
Michael Chamberlain	CCAB Chairman
Allan Cook	Technical Director, Accounting Standards Board
Henry Gold	Technical Director, ICAEW
Michael Lawrence	Chairman, the Hundred Group of Finance Directors
Bill Morrison	Chairman, Auditing Practices Board
David Tweedie	Chairman, Accounting Standards Board

IN ATTENDANCE:

Robert Coker Assistant Secretary, FRC/ASB

1 The Chairman said that this meeting was taking place following the agreement at the first meeting on 30 June 1993 that a further meeting should be held to review the 'overload' question. The Press had become aware of the meeting, and it would therefore be necessary to issue a statement to release to the Press after the meeting; this should be in the context of work arising from the Cadbury Committee's Report, the matter of particular press comment.

2 Mr Lawrence said that his position remained as he had stated at the CBI Conference. There was concern about the amount of material being issued and the priority was to co-ordinate this and to be able to sell it to companies. The Cadbury Committee recommendations were only part of the published requirements; there was also APB and ASB material, some of which was purely standard setting and some concerned with other topics such as interim reporting. He had called a special meeting of Hundred Group members for 11 October 1993, and already some 90 members had indicated they would be attending. This meeting would allow the Hundred Group Executive to obtain a full appreciation of members' views.

3 The Chairman said that there were a number of different elements affecting the 'overload' question. These were the timing of the initial documents asking for comments, the period provided for consultation, the publication dates of the final documents, and the time allowed until the text needed to be implemented. He thought that the problems could be eased by working on these variables and, for example, correlating the exposure periods of papers, such as those on internal control, being issued by more than one body. Publication of the Working Group's internal control paper had been postponed following the last meeting and there was now a strong desire, three months later, to issue it.

4 Mr Lawrence said that the three post-Cadbury issues raised different questions. If the Working Group wished to expose its paper on internal control then it must do so. However, his concern was that, while a good paper, it went beyond Cadbury and the financial aspects of Corporate Governance and dealt with internal control as a broad issue affecting the Boardroom as a whole. It was therefore misleading to regard the paper as a response to Cadbury recommendations. A body consisting solely of accountants had broadened the debate, without any authority to do so, and he thought that to publish the paper as it now stood would be a brave step.

5 Mr Chamberlain said that while some people did not wish to see the scope widened, there were others who were asking to see the paper in order to obtain guidance so that they could get on with implementing the Cadbury Committee recommendations, and it would be a dis-service not to respond to this demand. His second point was that, as regards the final content of the document, the comments which would be received during the consultation period would be relevant to this. Mr Lawrence accepted that there was a demand for a document of the kind envisaged by the Cadbury Committee. The Hundred Group supported Cadbury, and its concern was that this document would be seen as provocative since it would range over issues which were not purely financial, though prepared by accountants. Its timetable had not been the subject of consultation with the Hundred Group, whose view was that it would be best to remove all non-financial aspects of the paper or delay it. Mr Gold pointed out that the internal control paper represented some sort of compromise, since some bodies such as the Institute of Internal Auditors had argued that it should be broader still. The Cadbury Committee in its draft report had indeed talked of internal financial control, but in response to representations from bodies such as the Institute of Internal Auditors it had dropped the word 'financial' in the final report. The Working Group's paper had therefore had to include discussion of the scope of the directors' report on internal control. The Working Group had concluded that it was sufficient for the directors to report on internal financial controls. Mr Gold indicated the Working Group's willingness to be flexible over the length of the consultation period and to co-ordinate this with the APB. Mr Lawrence reiterated his view that the correct response to the Cadbury Committee's recommendation on this issue would be a paper dealing only with the financial aspects of internal control. Mr Chamberlain said that the Institute's view was that issue of the paper could not be delayed beyond end September. Mr Lawrence said he would have to reserve the Hundred Group's position on whether it could support this document pending the 11 October meeting.

6 The Chairman said that the Working Group's offer to relax the length of the exposure period was helpful, as would be an early indication of how far ahead final implementation was likely to be. Mr Morrison said that after the Working Group's document was issued (scheduled for end September 1993), the APB would follow with its paper around the end of November. If the Working Group extended its consultation period to the end of February or March, this could also be the closing date for comments on the APB paper, which of necessity would need to be issued after the Working Group's. The two bodies could then correlate their work on this issue, with the final guidance documents from each being issued at the same time and coming into force on the same date. He also thought it would be sensible to

allow a sufficiently long period before the implementation date. The Chairman suggested that final implementation was unlikely before some time in 1995.

7 On the second Cadbury issue, going concern, the Chairman said that the Working Group and APB still had to arrive at an agreed approach to put before the Cadbury Committee on 24 November. Mr Gold confirmed that this would be done during October and the first half of November. The Chairman referred to the difficulty of extending the period for the small/medium sized companies operating in uncertain trading conditions, or of easing that problem by having different definitions of going concern according to the size of a company. There was also the question of the authority of the statement to be issued. Mr Lawrence said that he was not au fait with the responses received to date on this issue, but understood that some concern had been expressed and that there was a problem with the banks. On the question of authority, he suggested that further consultation might be necessary if the consultation to date had not wholeheartedly endorsed the proposals. Mr Gold stated that a relatively small number of comments had been received, but it was difficult to draw the conclusion that there was any great opposition to the proposals. The bankers' point was important, since the BBA was refusing to issue guidance to its members on how they should respond to auditors' questions about the renewal of facilities. He doubted whether such guidance would be issued until the time came when auditors started applying to individual banks asking these questions. Mr Cook made the point that it was companies, not the banks, who would be first in the firing line, and it would be difficult for them to make any statement if the banks did not respond. Mr Lawrence asked whether, if the documents from the two bodies went before Cadbury in November and were accepted by the Committee, they would become operative for the 1993 reporting year. Mr Morrison said that the APB was arranging to have discussions with the Working Group on certain points, after which the two bodies could move forward in tandem. The Cadbury Committee could either urge re-exposure or agree to the proposals put to it. The Chairman said he thought it would be reasonable for this issue to be put to the Cadbury Committee on 24 November, provided the Working Group and APB agreed a joint line in time for this, but believed that a sufficient period should always be allowed before implementation, which should not apply to 1993 Accounts.

8 On the third issue arising from the Cadbury Committee recommendations, namely interim financial reporting, Mr Chamberlain said that the Institute was carrying out this work for the ASB and was proposing only a limited pre-exposure to a relatively small number of consultees. He believed that guidance on this question was long overdue, and there was a demand for it; he would therefore wish to adhere to the current timetable and submit revised proposals to the ASB in February 1994. Mr Tweedie confirmed that the issue would be re-exposed by the ASB in due course. This was an issue which arose from the Cadbury Committee recommendations and, since the ASB did not currently have the time and resources to deal with it, it had asked the Institute to assist.

9 With regard to the ASB output, the Chairman asked if one of the two accounting standards scheduled for publication in December 1993 could slip into next year. Mr Cook agreed that this could be done. He pointed out that the ASB had been criticised not so long ago for its lack of output, and there was a general

expectation that it would issue two accounting standards each year. If one of the 1993 standards slipped to early 1994 this should not affect the original two FRSs scheduled for next year.

10 Summarising the situation on outstanding Cadbury Committee issues, the Chairman said that only one large document was due to be issued in the near future, that by the Working Group on internal control reporting. The paper on interim financial reporting would have only a limited exposure, while the Cadbury Committee would consider the going concern issue at its November meeting if the Working Group and APB reached a common position by then. He would report to Sir Adrian Cadbury, who had been unable to attend the meeting, and also seek his agreement to a short press release being issued. It was agreed that this press notice should summarise the present position on the outstanding issues arising from the Cadbury Committee report, make it clear that none of these issues would affect financial reporting for the current year, and indicate that meetings would continue from time to time to correlate the work arising from the Cadbury Committee's recommendations.

11 Those present agreed it would be useful to meet again in about two months' time.

CFACG(93)13

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

Law Society Guidance

1. This serves as a brief covering note for the attached papers concerning the Law Society guidance on directors statements, which were faxed to the Secretary by Nigel Macdonald this morning. (Apologies for the quality of the copies.)
2. As he is unable to attend the meeting in person on 24 November, the Chairman will be introducing this matter on his behalf.

Gina Cole
19 November 1993

THEODORE GODDARD

From the office

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1st November 1993

Robert Charlesworth, Esq.,
Secretary,
Auditing Practices Board,
PO Box 413,
Moorgate Place,
London EC2P 2BJ.

Dear Mr. Charlesworth,

Cadbury Committee Code of Best Practice: Directors' Responsibilities Statements

The Law Society's Company Law Committee has been considering the wording which some companies have already included in their reports and accounts regarding Directors' responsibilities, in response to the requirement in the Cadbury Committee's Code of Best Practice. The Committee is concerned at the wide scope of some of the statements which have been published and the fact that, by doing so, companies run the risk of extending the legal liability of directors unnecessarily and beyond what appears to be contemplated by the Code of Best Practice.

An article is to be published shortly in The Law Society's Gazette, setting out suggested wording and commenting upon it. I attach an advance copy for your information.

As you will see, the Committee does not suggest there is a single formulation which is appropriate in all circumstances.

Yours sincerely,

MARTIN G. CHESTER
Chairman
The Law Society Company Law Committee

RECIPIENT	DATE REC'D	DATE PASSED ON
SMCA		
2 NOV 1993		
ASSIGNED TO (FOR ACTION)		

REVISED DRAFT STATEMENT

Statement of Directors' responsibilities in relation to Financial Statements

The following statement, which should be read in conjunction with the Report of the Auditors set out below, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditors in relation to the financial statements.

The Directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss for the financial year.

The Directors consider that in preparing the financial statements [on pages - to -], the Company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed [, subject to any explanations and any material departures disclosed in the notes to the financial statements].

The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors have co-operated fully with the Auditors in order to enable them to give their opinion set out below.

[Article for inclusion in The Law Society's Gazette]

Directors' responsibilities
in relation to Financial Statements

The Law Society's Committee on Company Law has had its attention drawn to the way in which a number of companies have responded to the requirement in the Cadbury Report that a statement should appear in Accounts explaining the Directors' responsibilities in relation to the preparation of the Accounts. Paragraph 2 of Appendix 3 to the Cadbury Report sets out four points which should be covered.

Although paragraph 2 of Appendix 3 to the Cadbury Report does not seek to prescribe the text of the explanation but simply to identify the points to be covered, it would seem that some companies have followed the wording in paragraph 2 literally. Other companies have closely followed example wording put forward in May 1992 by the Auditing Practices Board as an Exposure Draft and updated in May 1993 (SAS 600).

The Committee is concerned that it appears that responsibility statements are being published without legal advice being taken on the implications of so doing or upon the accuracy of the legal statements which appear in them. Companies which do so run the risk of extending the legal liability of directors unnecessarily.

A Working Party of the Committee (including leading counsel) has produced a draft form of responsibility statement, together with explanatory notes, the text of which is set out below.

In embarking on this exercise and in publishing the draft statement and notes the Committee does not seek to suggest that there is a single formulation for such statements which is appropriate in

all circumstances for all companies wishing to comply with the Cadbury Report. Whilst the draft statement addresses certain issues which are commented upon in the notes, the statement does not purport to provide an exhaustive explanation of the responsibilities of directors in relation to both group accounts and separate company accounts.

The Committee therefore considers that companies issuing responsibility statements, including those based on the draft set out below, should take legal advice on them.

**Statement of Directors' responsibilities
in relation to Financial Statements**

The following statement, which should be read in conjunction with the Auditors' Statement of Auditors' Responsibilities set out below, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditors in relation to the financial statements.

The Directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss for the financial year.

Following discussions with the Auditors, the Directors consider that in preparing the financial statements [on pages - to -], the Company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed [subject to any explanations and any material departures disclosed in the notes to the financial statements].

The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors, having prepared the financial statements, have requested the Auditors to take whatever steps and undertake whatever inspections they consider to be appropriate for the purpose of enabling them to give their audit report.

Notes

1. The first paragraph of the above draft has been included to state the purpose of the Responsibility Statement and for whose benefit it is made. It may also limit the use to which the Statement can be put. It also includes a reference to the Auditors' Report, which addresses the same points from the Auditors' point of view, and sets the context in which it is to be read.
2. The second paragraph reflects S.226 and S.227 CA 1985 (but there is a reference to financial statements rather than balance sheets and profit and loss accounts, or individual accounts or group accounts: also S.227(3) refers to group accounts, insofar as they concern the members of the Company).
3. The third paragraph follows Cadbury rather than SAS 600 but describes the accounting policies as "appropriate" rather than "suitable". However, the confirmation required is expressed as an opinion. The opinion as to accounting policies reflects SSAP2 and also Schedule 4 CA 1985; and as to accounting standards Schedule 4 CA 1985.

4. The fourth paragraph reflects Section 221 CA 1985. There is therefore no reference to adequate accounting records, nor to the SAS 600 reference to proper ones.

 5. The fifth paragraph includes a reference to the general responsibility of Directors for safeguarding assets and to prevention and detection of fraud or other irregularities. SAS 600 includes a reference to reasonable steps but only in relation to fraud and other irregularities: this concept has been extended to the safeguarding of assets limb of this statement.

 6. The sixth paragraph has been added to complement the statements relating to the Auditors' responsibilities which will, if example 3 of the APB's May 1992 exposure draft is followed, appear in the Auditors' Statement of Auditors' responsibilities.
-

STATEMENT OF DIRECTORS' RESPONSIBILITIES
IN RELATION TO FINANCIAL STATEMENTS

(1) Comparison of SAS 600 and Law Society suggested wordings

Changes to the example in Appendix 3 of SAS 600 shown in redline and strike out

~~The following statement, which should be read in conjunction with the Auditors' Statement of Auditors' Responsibilities set out below, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditors in relation to the financial statements.~~

~~The directors are required by the Companies Act 1985. Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the Group as at the end of the financial year and of the profit or loss for the financial year of the company for that period. In preparing those financial statements, the directors are required to~~

~~• select suitable~~

~~Following discussions with the Auditors, the Directors consider that in preparing the financial statements [on pages - to -] the Company has used appropriate accounting policies consistently applied and then apply them consistently;~~

~~• make and supported by reasonable and prudent judgements and estimates; that are reasonable and prudent;~~

~~• state whether applicable and that all accounting standards which they consider to be applicable have been followed, subject to any material departures disclosed and explained in the notes to the financial statements;~~

~~• prepare the financial statements on the going concern basis unless it is~~

~~inappropriate to presume that the company will continue in business¹.~~

The directors ~~have responsibility~~ ~~are responsible for keeping for ensuring that the~~ Company keeps proper accounting records which disclose with reasonable accuracy at ~~any time~~ the financial position of the company and ~~which~~ to enable them to ensure that the financial statements comply with the Companies Act 1985.

~~The directors have general responsibility for taking such steps as are reasonably open to them. They are also responsible for to safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of to prevent and detect fraud and other irregularities.~~

~~The Directors, having prepared the financial statements, have requested the Auditors to take whatever steps and undertake whatever inspections they consider to be appropriate for the purpose of enabling them to give their audit report.~~

¹ If no separate statement on going concern is made by the directors.

(2) **Wording in Appendix 3 to SAS 600**

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements⁶;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business⁷.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

⁶ Large companies only.

⁷ If no separate statement on going concern is made by the directors.

July 1992

Memorandum by The Law Society's Standing Committee
on Company Law

Auditing Practices Board - Exposure Drafts on:-

- (1) The scope and authority of APB pronouncements
- (2) Auditors' reports on financial statements
- (3) Going concern

The Committee welcomes the opportunity of commenting on the Exposure Drafts issued by the Auditing Practices Board on the subjects set out above.

1. THE SCOPE AND AUTHORITY OF APB PRONOUNCEMENTS

We have the following comments on paragraphs 6 and 8 of, and note 1 to, the proposed statement:-

- (1) We think it would be helpful if the language used in paragraphs 6 and 8 followed more closely the language employed in Section 25 (and, where relevant Section 30) of the Companies Act 1989. In particular, we are not clear whether the reference to "withdrawal of registration" in the first sentence of paragraph 8 is intended to refer to the loss of (actual or deemed) membership of an RSB (Section 25(1)(a)) or ceasing to be eligible for appointment as a company auditor under the rules of an RSB (Section 25(1)(b)) or both.
- (2) The definition of an audit set out in Note 1 does not conform with that employed in the existing APC Explanatory Foreword, which refers to "the independent examination of, and expression of an opinion on, the financial statements of an enterprise". In particular, we think that the reference to an independent examination and opinion may be more appropriate than reference to an examination by, and opinion of, an external auditor.

2. AUDITORS' REPORTS ON FINANCIAL STATEMENTS

THE PREFACE

- (1) Increasing the value of auditors' reports

The Committee generally welcomes the revised forms of expanded opinion, which, in dealing with the descriptions of the responsibilities of directors and auditors and the basis of the opinion, meet many, if not all, of the concerns expressed by the Committee in its memorandum of November 1991 on the APB's earlier proposals for an expanded auditors' report. The Committee does not propose to repeat in this memorandum the comments made in its memorandum of November 1991 save that, insofar as the new forms of opinion are designed to assist in closing the "expectation gap" we continue to think that it is important to convey that the words "a true and fair view" can only be fully understood against the general background of accounting principles, practices and conventions (as they evolve).

The Committee also generally welcomes the proposals which result in the removal from the auditors' report of a qualification in the case of uncertainties which are appropriately disclosed in the accounts.

(2) Legal and regulatory consequences of the proposed changes

The Committee agrees with what is said in relation to company law and other legislation in this section of the preface.

(3) Cash flow statements

The Committee generally agrees with what is said in this section of the preface. The second sentence of the third paragraph of the section alludes to the possibility of an audit report which is qualified in respect to a non-compliance with FRSI where no cash flow statement in accordance with FRSI is included in the financial statements, but in which there is no qualification of the opinion regarding the state of affairs and profit or loss. It may be considered appropriate to refer to this possibility in the notes to the proposed SAS and/or the Examples.

(4) Other opinions required by company legislation

The Committee believes that it is sufficient to include reference to these matters (e.g. those referred to in Section 237(1) of the 1985 Act) in that part of the auditors' report which describes the auditors' responsibilities, as set out in the Examples, rather than in that part which expresses the opinion.

(5) Summary financial statements

The Committee agrees with what is proposed in this section of the preface.

(6) General

It is not clear which sections of the preface are intended to be retained by way of introductory guidance when the proposed SAS is issued; the Committee believes that it would be helpful to retain, for example, the comments on cash flow statements.

THE PROPOSED SAS

Definitions

- (a) "Material" - The definition states that a matter is to be regarded as material if its omission or misstatement would be likely to influence the decisions of a user of the financial statements. It is not clear whether the reference to "a user" of the financial statements is intended to embrace only those persons to whom the auditor is formally reporting, i.e. in the case of a company the members, or whether it is intended to embrace a wider class of users; and the proposed statement on the scope and authority of APB pronouncements, which refers on occasion to "users", does not seem to offer guidance on this point. If a class of users wider than the members is intended, then, in the absence of some further guidance as to which users should be taken into account, the definition is likely to give rise to uncertainty. Moreover, the concept of "influencing the decisions" of a person is, in itself, imprecise; what kind of decisions are intended to be referred to?

We are also concerned as to the intended meaning of the second sentence of the definition, in that it provides that materiality may be considered in the context of "the financial statements as a whole, the balance sheet, the profit and loss account..." Is it

intended that the word "may" implies "should, unless clearly inappropriate"? Is it also intended that the references to the financial statements as a whole, the balance sheet and the profit and loss account should be references to whichever of these is in point? We think the intended meanings should be clarified. Finally, should a reference to cash flow statements be included?

- (b) "Inherent uncertainty" - The word "inherent", used in this definition, is not explained, and the reference in the definition of a fundamental uncertainty to an uncertainty arising from inherent factors does not, it seems to us, add very much. We also question whether uncertainty can be defined in terms of the impossibility of determining an objective view as to the outcome of a situation. We suggest that it might be preferable to approach the matter by referring initially to the existence of a substantial lack of certainty as to the outcome of a situation or transaction which affects the entity concerned as at the date the financial statements are approved and then referring to the scale of the possible effects.

The status and intended implications of the second sentence of the definition are unclear to us; are they intended to have some prescriptive force? If so, we believe that the reference to "working assumptions" may need further explanation.

- (c) "Fundamental uncertainty" - We do not find the relationship between the first sentence and the second sentence of the definition very easy. We are also not sure that the word "pervasive" assists an understanding of the intended meaning; particularly as it is here combined with the word "material", whilst elsewhere (Note (d) to Standard 4) it is used as an alternative to that word.
- (d) General - The definitions of inherent uncertainty and fundamental uncertainty are not used in Standard 6, but instead are repeated in full in that Standard and its notes, with minor differences. We suggest that this should be rectified.

Standard 4

The effect of this Standard is that certain types of limitation will give rise to a partial disclaimer, whereas others will give rise to a full disclaimer. A disclaimer gives rise to a form of qualified opinion. The notes to the Standard do not however make any reference to the important material in relation to qualified opinions contained in the notes to Standard 5, in particular the matters raised in Notes (c) and (d) to Standard 5.

Standard 5 Note (b)

We believe that this Note should state expressly that qualified opinions may also fall to be given in the circumstances referred to in the last paragraph of Standard 6, namely where the disclosures of fundamental uncertainties in the financial statements are inadequate. Alternatively, that paragraph should be removed to Standard 7, with an appropriate cross reference in Standard 6.

Standard 6

Note (a), in repeating the definition of inherent uncertainties, adds examples of matters upon which directors may have formed working assumptions. These need to be reconciled with the corresponding sentence in the definition.

In the last sentence of Note (d), the opening words could we think more usefully read:- "When an opinion is qualified for some reason other than in respect of the disclosure or accounting treatment of the relevant fundamental uncertainty,".

The last paragraph of Standard 6 requires a qualified opinion only where disclosures of fundamental uncertainties are inadequate. We believe that it is intended that a qualified opinion should be given where the auditors disagree with the accounting treatment used in relation to such uncertainties - see for example the situation dealt with in Example 8. This should, we believe, be made clear.

3. GOING CONCERN

(1) Justification of going concern basis

The Committee welcomes and supports the view that it is an appropriate function of auditors to take specific steps to satisfy themselves that the going concern presumption is justified, by comparison with the rather weaker proposition contained in the subsisting auditing guideline. It is true that paragraph 10 of Schedule 4 to the Companies Act 1985 states that a company should be presumed to be carrying on business as a going concern; but this could not excuse the directors from considering whether the presumption is applicable in preparing the accounts in respect of any financial year and paragraph 15 of the schedule provides that "if it appears to the directors of a company that there are special reasons for departing from [... the presumption ...] they may do so, but particulars of the departure, the reasons for it and its effect shall be given in a note to the accounts".

(2) Proposed future period to be examined

The Committee generally supports the approach taken in Auditing Standards 1 to 4, but with the qualification that we doubt whether the period of one year from the date of approval of the financial statements is in all cases an appropriate period for the purposes of Standards 1 and 3. Paragraph 11 of the preface makes clear that such a period is longer than is currently required; nor in practice is such a period always applied. Moreover, even if such a period became the norm, we think that that the APB should consider whether the proposed period should be capable of variation according to the variability of the practicalities of forecasting in different industries.

In relation to this issue a further relevant factor is clearly that raised in sub-paragraph (e) on page 5 of the Exposure Draft, namely as to the availability in practice of appropriately firm confirmations from banks and financial institutions as regards continuity of finance facilities.

(3) Going concern - meaning of the concept

Paragraph 11 of the introduction contains a vitally important statement (albeit in a negative form) of the meaning of the going concern concept (and should, we believe, be embodied in the proposed SAS). The common feature of the first four factors is essentially that they entail an intention or need on the part of the company not to meet its commitments as they fall due, or to wind up on the ground of the form of insolvency which arises where the value of the liabilities exceeds the value of the assets. We think it would be more logical for paragraph 11 to be based on the insolvency tests (which are in essence those set out in Section 123(1)(e) and Section 123(2) of the Insolvency Act 1986, excluding the references to the court.)

We are hesitant as to the inclusion in the definition of the going concern concept of the reference to "curtailing severely the scale of the company's operations", although we appreciate that in this respect the proposed SAS does not diverge from the existing auditing guideline or from SSAP2. Cessation of business in consequence of being unable to pay debts as they fall due is a different matter from severe curtailment of business if that is not related to such an inability. There are frequently cases where a

company will make an orderly withdrawal from its major business, without any threat to its solvency, and thereafter concentrate on ancillary and/or newly acquired businesses. In such cases, it would seem appropriate, albeit with disclosed and explained adjustments to relevant asset valuations and/or liabilities or provisions, to continue to present the accounts on a going concern basis so far as the continuing business/ownership of assets is concerned. The Committee believes that the going concern concept is commonly understood to be closely allied to the question of solvency in the sense referred to above, and that it would not be appropriate that audit reports containing going concern qualifications (and/or matters of emphasis in relation to the going concern presumption) should be required in cases of changes in the scale of operations not involving insolvency.

(4) Group accounts

The proposed SAS does not contain guidance as to how its principles should be applied in the context of group accounts, which the Committee believes would be helpful. For example it may be the case that significant subsidiaries cease to be going concerns, whilst the holding company and other subsidiaries continue, and are able to continue, in business; in such a case the application of the SAS to the group accounts does not seem clear.

(5) Miscellaneous

(a) The Committee finds the statement in paragraph 13 opaque. If it is intended to point to the fact that a company may not be a going concern and may yet be solvent in the sense that its assets exceed its liabilities, then the Committee believes that that point should be made more clearly.

(b) Standard 5 refers to the disclaimer of an opinion through limitation in scope; here a cross-reference to the explanation of that concept in the SAS on Auditors' Reports would assist (cf note to Standard 8).

(6) Cadbury Committee

Since the Exposure Draft was published the draft report of the Committee on the Financial Aspects of Corporate Governance has also been published. It seems to this Committee that the recommendations in that report in relation to the going concern basis are generally consistent with the proposals of the APB.

July 1992