

CFACG(95) 1st Meeting

COMMITTEE ON THE FINANCIAL ASPECTS OF  
CORPORATE GOVERNANCE

The next meeting of the Committee will take place on Tuesday 7 March 1995 at 3.00pm, in Committee Room 3, 23rd floor, the London Stock Exchange, London, EC2N 1HP.

Agenda



Apologies for absence.  
Minutes of the meeting held on 7 December 1994, attached.



Independence of Directors. Letter from PIRC dated 21 February 1995, attached.



Monitoring Sub-Committee, Draft Report on Compliance with the Code of Best Practice - CFACG(95)1, attached.

4. Any other Business *Invites to dinner 15<sup>th</sup> May.*

5. Date of next meeting - Wednesday 10 May 1995 at 3.00pm.

Gina Cole  
Secretary  
2 March 1995

*a) indepdce. weakened by being co-members of a holding board.*

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

**Minutes of the meeting held on Wednesday 7 December 1994  
at the London Stock Exchange**

Present:

Sir Adrian Cadbury  
Sarah Brown  
Jim Butler  
Jonathan Charkham  
Hugh Collum  
Sir Dermot de Trafford  
Andrew Hugh Smith  
Andrew Likierman  
Sir Sydney Lipworth  
Nigel Macdonald  
Mike Sandland  
Mark Sheldon  
Martin Taylor  
Sarah Andrews

Also in attendance for Item 3:

Philip Ashton  
Richard Chinn  
Paul Rutterman  
Mike Townsend

**Agenda Item 1**

1. There were no apologies for absence

**Agenda Item 2 - Minutes of the last meeting**

2. The Chairman advised that a request for an amendment to paragraph 9 under Agenda Item 2 had been received from Martin Taylor. It should now read :-  
"Martin Taylor said there might be a danger that companies' boards would specifically say that they had no legal responsibility for the effectiveness of the internal controls since they would believe that if they did not make such a statement it would be assumed that they were vouching for the effectiveness and that this would expose them to greater risk of liability, particularly in the USA."

No other requests for amendments had been received.

### Agenda Item 3 - Internal Control

3. Paul Rutterman introduced the issues on which concern had been expressed in response to the revised draft guidance. The first on the definition of a reportable weakness had been resolved by the Working Group. The second arose in connection with expressing an opinion on the effectiveness of systems of internal financial control.
4. A majority of the responses received by the Working Group were against encouraging boards to express a view on the matter; they included a number of companies, the CBI, major audit firms, ICAEW, APB and the Law Society. Their main concerns were potential exposure to legal liability and giving unwarranted assurance. Organisations which might be said to reflect the consumer interest, plus ACCA, ICAS, CIPFA, IIA and the Bank of England found the proposed wording too weak. The Working Group were divided with a majority in favour of encouragement.
5. A constructive debate among Committee members followed. Points against encouraging an expression of opinion on effectiveness included:-
  - such an opinion could give rise to a liability or to the perception of one;
  - auditors would have difficulty in reporting on such expressions of opinion; a letter from the major firms' heads of audit said "it would be difficult for us to distance ourselves from their (the directors') opinion, to do so would at best involve some rather clumsy wording; at worst it would appear negative".
  - if directors were sued for negligence, a collective statement on effectiveness could weaken their case;
  - the legal position in jurisdictions outside the UK needed to be taken into account;
  - it was hard to envisage what form of words a director could safely use (examples would help);
  - the Report and the Code had focused attention on internal financial controls, would much be gained by encouraging expressions of opinion?
6. Those who supported what had been referred to as the consumer interest made the following points:-
  - The lack of effective internal financial controls had been one of the main reasons for setting up the Committee;
  - the aim of reporting on effectiveness should remain a goal and the issue was how best to make progress towards it;

- by encouraging expressions of opinion, possible ways forward could be identified and it was hard to see how this could be done without practical experience to build on;
  - companies were to be encouraged, not required, to express an opinion; it might be that large companies would make a statement, medium-sized companies would only act on professional advice and small companies would ignore the matter; this could still provide a useful basis for the successor body to determine its policy on effectiveness.
7. Much of the debate centred on the legal issues involved. It was suggested that provided the directors had taken the appropriate steps to establish that their system gave reasonable assurance of effectiveness, a failure within the system would not of itself render them liable. It did not seem to be feasible to seek an overall legal opinion on whether new liabilities could be created by the proposal, as the legal position would have to relate to the circumstances of the company concerned.
  8. There was also discussion about how opinions on effectiveness might be expressed. The statement should describe the process, refer to the way in which benefits had been weighed against costs and make clear that only reasonable assurance could be given. Bland statements should be discouraged. It would be helpful to study examples of US forms of wording.
  9. In conclusion, the majority of the Committee were in favour of retaining the aim of reporting on effectiveness. Statements on effectiveness would test opinion on the matter and provide guidance to the successor body. Given the reservations of directors and auditors, the Working Group was asked to consider a form of words which would leave it open to boards to follow their own judgment in the matter, while still making it clear that expressions of opinion on effectiveness would be welcome.
  10. Whatever form of words was finally agreed, following the Working Party's guidance would for the present be regarded as constituting compliance with the Code.

#### **Agenda Item 4 - Issues for the Successor Body**

11. Sir Sydney Lipworth reported on the progress made by the FRC over the future of the Committee. It had been agreed that there should be a successor body and that it should be a continuation of the existing committee with the addition of new members and under a new chairman. Its remit would be determined by its sponsors, who were at present FRC, LSE, CBI, IOD, and the accountancy profession. Sir Sydney was looking to include representation from investors among the sponsors and aimed to complete his discussions with them by the end of January.

NAPF, ABI.

12. It was felt important to be clear where ownership of the Code and the ability to change it would lie. Equally, the committee should avoid becoming a body which made rulings on the application of the Code along the lines of the Takeover Panel. It was pointed out that the monitoring exercise itself would bring out issues for the new committee's agenda and that directors' remuneration would have to be addressed. The committee would pick up items as they arose, but already had a heavy prospective workload in terms of the list prepared by the Secretary.
13. The list was welcomed and the next stage would be to group the items on it and allocate priorities. One of the roles of the committee could be to bring some of the wider issues, such as the investment policies of the institutions and shareholder involvement in general, to a point where they could be usefully debated more widely. For example, Nigel Macdonald proposed that one area which could be investigated was the separation within the institutional investors of their "core" holding in a company (i.e. that percentage of the equity which varied only slightly over time), and that part of the equity which they traded more frequently. This might enable the institutions to forge a closer relationship with the companies on the basis of the "core" holding, which might be freed from insider dealing regulation, and more transient holdings which would remain subject to it. All this would of course be subject to investigation of the institutions' trustee responsibilities, and an assessment of the cost in relation to likely benefits.
14. The present Committee had broadened out from its original remit, but had done so incrementally. While there was logic in widening the terms of reference, any extensions of the new committee's activities would have to command the support of the sponsors.
15. The DTI had responded to the Committee's enquiry about progress on the recommendations requiring changes to the Companies Acts and the offer of a presentation at the start of the March meeting was warmly welcomed. The DTI were bringing out a green paper on directors' fiduciary duties early in the New Year.

#### **Agenda Item 5 - Monitoring compliance with the Code of Best Practice**

16. The interim report on monitoring compliance with the Code was judged to provide an encouraging picture of the response at this stage to the Committee's recommendations and would provide the benchmark against which to judge future progress. The Monitoring Sub-Committee were asked whether it would be possible to gauge in any way how far institutional shareholders had responded to the recommendation that they should make their policies on voting known.

#### **Agenda Item 6 - Publication of Survey Results**

17. The committee strongly supported full publication of the survey results, but pointed out the importance of doing so in a positive way. We had an

encouraging picture to present and need to stress that the measure of success was disclosure rather than, at this stage, compliance.

### **Agenda Item 7 - Disclosure of Directors' Share Options/UITF 10**

18. A request had been received from the major accounting firms, but not from the ASB/UITF, "specifically to endorse the UITF guidance" as giving effect to the Code's recommendations. While welcoming the UITF guidance on a complex matter, this request would take the Committee beyond its own recommendations (which did not cover all directors individually) and it was not in a position to give rulings on the application of the Code. The chairman would reply along those lines.

### **Agenda Item 8 - Debt-listed only companies**

19. The Committee agreed with the guidance given by the Secretary over debt-listed companies and endorsed actions a) and b).

### **Agenda Item 9 - Arlen plc**

20. It now appears that Arlen is likely to comply in future and there had been investor pressure for them to do so.

### **Agenda Item 10 - Letter from Mr J R Gillum**

21. Mr J R Gillum's letter was noted and the Chairman was asked to reply. The Committee could not become involved in the detailed agenda of audit committees, but Mr Gillum's case study could usefully be drawn on in training courses for directors.

### **Agenda Item 11 - Any other business**

22. The request by UKSA for endorsement of their proposed remuneration enquiry was turned down and the chairman was asked to write accordingly.

### **Agenda Item 12 - Date of next meeting**

23. The next meeting will be held at 3.00pm on Tuesday 7 March 1995, at the London Stock Exchange.

21 February 1995

Sir Adrian Cadbury  
Chairman  
The Committee on the Financial Aspects  
of Corporate Governance  
c/o The International Stock Exchange  
London EC2N 1HP

Dear Sir Adrian,

**Compliance with the Code of Best Practice  
and Independence of Directors**

At Jonathan Charkham's suggestion, we are writing to request formally that the Committee considers a matter which has arisen and which, in our view, has very great importance for the role of shareholders in the corporate governance process.

As you know, we provide a Corporate Governance Service for institutional investors in the UK and the USA. In our Reports on companies we include voting advice based on our published Guidelines and also our independent analysis of compliance with the Code of Best Practice. In doing so, we consider we are helping institutional investors fulfil their responsibilities for ensuring compliance with the Code as envisaged in the Committee's Report.

One of the most important areas where we apply our analysis is the issue of non-executive directors' independence. We very much welcome the clear guidance in the Committee's Report about the need for non-executives to be in a position to take an independent view to that of the executive directors. Accordingly we have developed criteria which we use in assessing independence. These criteria were set out in our Shareholder Guidelines 1994, which were sent to all FT-SE A All Share Index companies in March/April 1994. I attach a copy for your reference.

Our assessment of independence contributes to our view on whether companies comply with the Code of Best Practice. Our practice has been to state our opinion on compliance in our Corporate Governance Reports.

We have been aware of the statement in the Report that "It is for the board to decide in particular assess whether this definition [of independence] is met". However, our opinions on independence and compliance are not intended to supersede those given by the directors. Rather, they represent an independent assessment which shareholders may use to inform their analysis of corporate governance.

Pensions & Investment Research Consultants Limited  
Crusader House, 145-157 St. John St., London EC1V 4QJ  
Telephone 0171-250 3311 ■ Facsimile 0171 251 3811

Registered No. 2300269

Member of the Financial Intermediaries, Managers & Brokers Regulatory Association



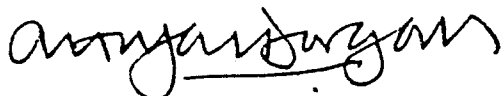
A major company has now challenged whether we can make an assessment of independence which differs from that of the Board, and whether we can therefore make an assessment of compliance with the Code of Best Practice. The company's view is that we "are not at liberty to say that the company does not comply with the Cadbury Code, since the Code itself entitles the Board to make the determination...." The company also states that the Board has considered the question of independence in coming to its view that the company complies with the Code of Best Practice.

At no stage are we suggesting that the directors have acted in bad faith in arriving at their view. However, it appears to us that there is room for more than one opinion on matters of independence and therefore compliance.

PIRC believes that if Boards have sole determination of whether their non-executives are independent, then shareholders are hamstrung in their ability to exercise their responsibilities in the corporate governance process. Board are in effect acting as judge and jury and may make any determination they like. This will stifle debate on this important area and render the Code of Best Practice considerably less effective.

We hope that the Committee can treat this issue as one of the utmost importance. It not only has ramifications for our approach to corporate governance on behalf of our clients, but more importantly, for the credibility of the Code itself.

Yours sincerely,



Alan MacDougall  
Joint Managing Director

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

**Publication of the Monitoring Report**

1. A draft of the Report on Compliance with the Code of Best Practice is attached. This draft has been amended to take on board comments and suggestions made by the Monitoring Sub-Committee at its meeting on 23 February 1995.
2. The Committee are asked to consider the Report and propose any final amendments prior to its publication.

Publication Details

3. The Secretary has been in discussion with the Report and Code's publishers, Gee and Co., who have agreed to also publish the Report on Compliance. Gee will take copyright of the work, and will provide the Committee with sufficient free copies for distribution to listed companies and ABI membership. The Report will be produced in the same style as the Report and Code, and printed in two colours (black and blue). It is likely that Gee will sell it for around £7.50 per copy, working on the basis that it will comprise 32 pages of A5. (The price may in fact be less as it seems likely that the number of pages has been reduced subsequent to the discussions with Gee.)

4. The above is a record of the verbal agreement between the Secretary and Gee & Co. No written contract has yet been signed on the Committee's behalf.

Press Conference

5. It is proposed that the Report on Compliance is launched at a press conference. The Stock Exchange have raised no objection to it being held here. The Chairman has agreed that he should lead such a press conference.

6. The timing of the press conference will be dependent on when the publishers receive a final draft from the Committee. Indications are that there will need to be a 4-5 week lead time before printed copies would be available.

7. The Secretary will also need to liaise closely with the Committee's current sponsors to ensure that the proposed date does not conflict with any possible announcements to the press on the formation of the Committee's successor body.

Gina Cole  
Secretary  
2 March 1995

## Committee and Sub-Committee Members Future Meeting Dates and Times

### Members

Sir Adrian Cadbury (Chairman)	0564 772931
Martin Taylor - Vice Chairman, Hanson plc	245 1245
Jim Butler	628 9151
Jonathan Charkham	589 9879
Hugh Collum - Finance Director, SmithKline Beecham	081 975 2028
Sir Sydney Lipworth - Chairman, Financial Reporting Council	404 8818/726 1184
Andrew Likierman - Head of the Government Accountancy Service	270 4530
Nigel Macdonald - Partner, Ernst & Young	931 3555
Mike Sandland - Ex-Chief Investment Manager, Norwich Union	0603 54212
Mark Sheldon - Joint Senior Partner, Linjaters & Paines	606 7080
Sir Andrew Hugh Smith - Ex Chairman, London Stock Exchange	0296 770200/ 770078 - bus/fax
Sir Dermot de Trafford, Bt - former chairman, Institute of Directors	0264 772357

### Observers:

Sarah Brown - Head of Companies Division, DTI	071 215 3190
---	--------------

### Secretary:

Gina Cole

### Advisor:

Sir Ron Dearing	071 404 8818
-----------------	--------------

### Sub-Committee Members

Andrew Likierman - Head of the Government Accountancy Service	270 4530
Mike Sandland - Ex-Chief Investment Manager, Norwich Union	0603 54212
Jonathan Charkham	589 9879
Sir Dermot de Trafford - former chairman, Institute of Directors	0264 772357
Sir Andrew Hugh Smith - Ex Chairman, London Stock Exchange	0296 770200/ 770078 - bus/fax
Martin Taylor - Vice Chairman, Hanson plc	245 1245
Nigel Macdonald - partner, Ernst & Young	931 3555

Andrew Hutchinson - Institute of Directors (if Sir Dermot can't make it)

### Secretary

Gina Cole

### Future Meeting Dates

6 September 3.00pm - Sub Committee - cancelled  
14 September 3.00pm - Full Committee  
29 November 3.00pm - Sub Committee  
7 December 3.00pm - Full Committee  
2 March 1995 3.00pm - Sub-Committee  
7 March 1995 - Full Committee  
~~4 May 1995 3.00pm - Sub Committee~~  
10 May 1995 - Full Committee