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14 November 1994

Sir Sydney Lipworth QC
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Dear Sydney.

I was glad to have the chance of a word on the phone over the way in which the Committee's work should be followed up and you have probably seen the statement which appeared in the DTI Bulletin on Company Law Developments.

I would have thought that the best option would be for a new Committee to be formed with some overlap of membership with the present Committee to provide continuity. The only body which could take on the work would be the FRC and that might be seen as favouring the accounting over the business approach to corporate governance.

I am quite clear that I should retire as chairman next June. There is no doubt about the need for a thorough review and this has to be undertaken by someone who was not as closely involved with the Report and the Code as I was.

Perhaps the first point to clear is who the sponsors are to be. This will then lead on to the remit of the new Committee, where it is to be based and who is to chair it. It would, for example, seem sensible to ask major sponsors for names of possible chairmen. It will need to be someone who will carry weight in the business world and your suggestion of Sir Denys Henderson would be admirable. Other names that come to mind are Sir Christopher Hogg, Sir David Walker and Geoffrey Wilson, Chairman of Delta.

Gina Cole has drawn up a useful list of issues which could be on the agenda of the new Committee and I do not underestimate the task which it will be taking on. It is inheriting a "going concern", but it will be faced with difficult decisions over possible revisions for the Code.

I am grateful to you for getting the process under way and I look forward to the discussion at our meeting on 7th December.

With best wishes.

*Yours,
Adnan*

Sir Sydney Lipworth QC

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17 November 1994

Sir Adrian Cadbury
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Dear Adrian,

Successor to the Cadbury Committee

Thank you for your letter of 14 November and very constructive suggestions. While I am disappointed that you would not consider continuing as Chairman of the Committee, I can quite understand your reasons. On balance, I must admit that I believe you are correct in thinking that a new Chairman would be preferable in order to bring fresh ideas to bear. It is obviously difficult to review your own decisions.

On the other hand, although for the same reason it is probably preferable to have a new Committee on which there may be some members of the existing Committee, there is also a strong argument for retaining the existing Committee with some members standing down and being replaced by new blood. In that way, one would get the benefit of greater continuity.

This would be a matter for the sponsors to decide. As you will see from my note to the FRC for our Council meeting next week, I have sought their views on this issue and some of the other questions. I shall, of course, mention your view in introducing the subject.

With warm regards,

J. Cur,

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FINANCIAL REPORTING COUNCIL
SUCCESSOR TO THE CADBURY COMMITTEE

Paper by the Chairman

Decisions required

1. As I set out in later paragraphs, the FRC was one of the original sponsors, together with the London Stock Exchange and the accountancy profession, of the Cadbury Committee. Since then, additional sponsorship and financial support has come from the Institute of Directors and the CBI.
2. The Cadbury Committee's stated term is due to come to an end on 30 June 1995, but that Committee has assumed that a successor body will be established to review the operation of the Code and to consider what further steps are needed for effective corporate governance.
3. The FRC is expected to take the lead in convening a meeting of the sponsors with a view to nominating a successor body.
4. The Council is asked:
 - (a) to authorise me to convene a meeting of the sponsors;
 - (b) to express views as to whether a successor body to the Cadbury Committee is required; and
 - (c) if so, whether it should be a new body or a continuation of the existing Committee with some new members replacing some of the existing members (including its Chairman who has intimated that he wishes to stand down).

Background

5. The Cadbury Committee was set up in May 1991 by the FRC, the London Stock Exchange and the accountancy profession to address the financial aspects of Corporate Governance. The Committee's membership is set out in Appendix 1.

The reason for establishing the Committee was the sponsors' concern "at the perceived low level of confidence, both in financial reporting and in the ability of auditors to provide the safeguard which users of company reports sought and expected. The underlying factors were seen as the looseness of accounting standards, the absence of a clear framework for ensuring that Directors kept under review the controls in their business, and competitive pressures, both on companies and on auditors which made it difficult for auditors to stand up to demanding boards".



These concerns were heightened by unexpected failures of major companies and by criticisms of the lack of effective Board accountability for matters such as directors' pay and internal controls.

Terms of Reference

6. The Committee's terms of reference were:

"To consider the following issues in relation to financial reporting and accountability and to make recommendations in good practice:

- (a) the responsibilities of executive and non-executive directors for reviewing and reporting on performance to shareholders and other financially interested parties; and the frequency, clarity and form in which information should be provided;
- (b) the case for audit committees of the board, including their composition and role;
- (c) the principal responsibilities of auditors and the extent and value of the audit;
- (d) the links between shareholders, boards, and auditors;
- (e) any other relevant matters."

The issues

7. Perhaps the first question that will need to be decided is whether or not there should be a new Committee or a continuation of the role of the present Committee. If it is thought that there should be an ongoing Committee to keep the Code under review and to consider other issues of corporate governance that might usefully be included, the question arises whether it should be the existing Committee, augmented by new members, or whether a new body should be created, and if so, what its composition and terms of reference should be.

In this regard, it may be appropriate to make the Committee's terms of reference a little more formal and to consider whether its membership should be widened to include interest groups not at present represented. Council members' views on these matters would be welcomed.

8. An associated issue will be the question of the financing of the new committee. Depending on its size and the task it undertakes, it may be that somewhat greater resources will be needed than for the present Committee. By the same token however, it may be that any extension of the interests represented may provide some additional sources of support.

Specific items for review

9. The most crucial issue, however, is the agenda that the successor or ongoing Committee is to tackle.



10. The Cadbury Committee's recommendation as to the appointment of a successor reads as follows (paragraph 3.12 to the report):

"We recommend that our sponsors, convened by the Financial Reporting Council, should appoint a new Committee by the end of June 1995 to examine how far compliance with the Code has progressed, how far our other recommendations have been implemented, and whether the Code needs updating in line with emerging issues. Our sponsors should also determine whether the sponsorship of the new Committee should be broadened and whether wider matters of corporate governance should be included in its brief. In the meantime, the present Committee will remain responsible for reviewing the implementation of its proposals and for identifying further issues which its successor body might usefully consider. These steps will establish a continuing process of governance review."

11. In addition to this general remit to review compliance and adoption of the Code, some specific general items were identified in the Cadbury Committee report as being issues that the successor body 'may wish to review or consider in greater depth' These were:

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

Further items for review

12. Since the report was published the Committee has considered some further issues and identified them as matters for consideration by its successor body. In no particular order of importance these are:



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

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

This list is not exhaustive. For example, more work may be desirable in the areas of internal control and going concern.



Conclusion

13. I should be grateful for guidance from Council members as to how I should carry out the FRC's remit and for preliminary thoughts as to the FRC's input to the successor body.

SYDNEY LIPWORTH

8 November 1994