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COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

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4th June, 1992

Tony Morton, Esq.,
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Dear Mr Morton,

Thank you very much for your letter of 31st May, 1992. I have read your comments with interest, and passed a copy to Sir Adrian Cadbury.

I confirm that your comments will be taken into account when the Committee considers its final report.

Yours sincerely,

Nigel Peace

Nigel Peace
Secretary

a Sir Adrian ✓

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31 May 1992

Nigel Peace
Secretary
Committee on the Financial Aspects of Corporate Governance
P.O. Box 433
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Dear Mr Peace

CADBURY COMMITTEE DRAFT REPORT

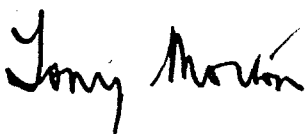
Enclosed are comments on the above, which I hope will be helpful.

Having had wide experience in three major multinationals, my remarks are to some degree picking up issues which I feel are not adequately covered for large companies. However I also have smaller company experience, and have seen both good and bad practices, even within parts of companies with the highest top level reputations.

Like so many people I have been horrified at the well publicised scandals of the past two years, but having seen similar things within subsidiary companies where there have been autocratic leaders, can see how easily they can take place if the will (not necessarily fraudulent) is there.

My belief is that the draft code needs sharpening up, and also has to recognize that there are many areas where directors, auditors, *employees*, and others have shared responsibilities. It is of interest to me that the role of the professional accountants and lawyers in businesses has not been addressed. They have the additional sanction of losing their qualifications, and this could perhaps be used as an additional factor in the monitoring process.

Yours sincerely



Tony Morton FCCA

COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE

Comments on the DRAFT REPORT

GENERAL COMMENTS

The basic premise that good Corporate Governance is better through a voluntary code than by statute has to be right. By incorporating this into Stock Exchange listing requirements there should be a sufficient incentive for companies to comply.

A major foundation of the code centres round the Internal Controls, which are already the responsibility of the directors. It is now recommended that they should report on them, with this in turn being reported on by the auditors. It is here that the code must be stronger and more specific in allocating responsibilities.

It is not possible, especially in a very large company, for the directors to be able to check either the detail of internal controls, or managements' adherence to them. Here it is essential for a higher degree of responsibility to rest with auditors, especially for divisions and subsidiaries.

Similarly it is often rare for auditors to have the technical or market knowledge that company employees have. Auditors must assess the adequacy of all internal control mechanisms, and whether the company is monitoring its own health and performance effectively. They must comment on this assessment.

It is to be hoped that the final code will be specific in suggesting the frequency of board meetings, since it is through these that the non executive directors can challenge and check in periods between statutory statements of results.

Access to information should include sufficiently detailed management accounts, and particulars of significant provisions required or expected. Without this it will be difficult for Audit Committees to function effectively.

The code is good. It needs to be sharpened up.

SPECIFIC COMMENTS

Para 3.3 The integrity of reports depends on the integrity *and care* of those who prepare and present them.

Paras 4.7 to 4.9

There can still be no guarantees of the calibre of the non executive directors, especially if they are chosen by the executive directors. If a company is already very tightly managed by a small number of directors it is difficult to see how they can be prevented from producing "sympathetic" nominees.

Para 4.11 The NEDs must have full access to suitably detailed management accounts as produced for internal use, including the right to ask on an ad hoc basis for additional information such as the management report of a troubled subsidiary, or the project review papers on a critical long term contract. This must be so if they are to provide any effective check on their company's performance and health between statutory accounting statements.

Para 4.19 The regularity of meetings, **and circulation of information between meetings**, should be more clearly specified.

Para 4.20 It would be wrong for many decisions to be delayed to wait for board meetings. Either transactions of a specified size should be notified to board members by circulation of papers (to allow them to question), or more practically items such as capital expenditure should be ratified at the next meeting.

With material loans, received or granted, terms and conditions should be put to the board.

In addition to the items specified directors should also be aware of any significant leases taken or granted, or any other major contractual matters which could have long term or potentially onerous effects on the business.

Paras 4.25 to 4.26 and Paras 5.1 to 5.6

In large and geographically diverse companies the responsibilities for internal controls have to be split between the directors and the auditors. It is also difficult to see how, for example, a research director can make the same quality assessment on internal controls as, for example, the finance director.

Para 4.29 All companies should have audit committees, and the guidelines of their duties are well laid out. However, there is a potential conflict if the NEDs do their jobs too well, and find matters of disagreement with the executives. They will not have their contracts renewed, since it is proposed that the executive directors make the appointments.

Para 4.50 Will the institutional shareholders accept any **responsibility** on behalf of other shareholders, where their closer links with managements should give them a better view of what is happening. ✓

Para 5.7 Auditors can rarely have the technical or market knowledge of a company that the executives have, and should rely very heavily on all forms of internal reporting and controls to assess whether the company is monitoring itself effectively. They should carry out a full systems audit, including non financial controls.

Para 5.20 The very knowledge of the potential consequences of qualifications about a company's financial viability should lead to earlier avoiding action being taken by, for example, making arrangements with banks and key creditors.

Paras 5.24 to 5.28

Much of the avoidance of fraud comes down to the effectiveness of internal control systems. If it is major and perpetrated by executive directors it is much more difficult to uncover, but the strengthened responsibilities of NEDs should make it much more difficult.

A. R. MORTON 31.5.92