

MEETING ON 17 SEPTEMBER 1992COMMITTEE'S CONCLUSIONS ON PROPOSED REVISIONS TO DRAFT REPORTTone

- Section 1 should be amended to seek to dispel view that Committee takes a negative view of governance. Points to consider incorporating: that efficiency and control go together; that lax governance tends to be symptomatic of lax management generally; and that investor confidence in governance leads to more effective functioning of the market.
- Definition of corporate governance at 2.5 should be reconsidered. Possible changes: replacement of 'the system by which companies are run' with 'the system by which companies are directed and controlled'; and replacement of second sentence with the following:

'Responsibility rests with the board of directors who must set the company's strategic aims, provide the leadership to ensure their implementation, supervise management and provide information regarding the companies affairs.'
- Consideration also to be given to alternative formulation that corporate governance is about getting the best out of entrepreneurial drive within a framework of accountability.
- Point to be made firmly in Preface to final report that Committee has only addressed the financial aspects of corporate governance, not the broader issue of corporate governance as a whole.

Criticism that proposals will divide the board

- Committee's support for the unitary board to be affirmed in 1.6, although not in such a way as to rule out companies adopting features of a two-tier structure if they want, or to prejudice future debate. Points for possible emphasis: (a) the Committee's proposals are founded on taking the existing system as it is; (b) the Committee does believe in debate round a single a boardroom table, and whilst it also believes that NEDs have particular responsibilities it does not agree that this undermines the idea of a unitary board.

- The equal responsibility of all directors for the governance of the company to be underlined early in section 4. Consideration to be given to making point along the lines that executive directors equally with NEDs have a supervisory role in accordance with the requirements of the Companies Act, and that the difference between the two is not that the NEDs additionally have supervisory responsibilities but that the executive directors additionally have functional responsibilities.
- 4.3 first sentence: 'are in the best position to monitor' to be replaced by 'have an important contribution to make in monitoring'.
- The proposal that NEDs should have an appointed leader (4.3, 4.6, Code 1.2): wording to be reconsidered in light of amendment proposed by Sir Ron Dearing:

'If the chairman is an executive director, a senior non-executive director should have recognised responsibility to advise the chief executive and if necessary raise with the board as a whole any well-based concern that the exercise of power vested in the combined chairman and chief executive was weakening the effectiveness of the board, or any of its members.'

(Committee discussion was inconclusive. Some members favoured the proposal that the senior NED should be appointed Deputy Chairman, but others felt that this was too prescriptive. Other suggestions were the replacement of 'leader' with 'focal point'; and relegation of the suggestion that there should be an appointed leader from the Code to 'good practice'.)

- The procedure for taking independent advice to be extended to all directors. The Committee should not seek to define the procedure.
- Membership of audit committees should continue to be restricted to NEDs but - to retain consistency with the principle that all board members have stewardship responsibilities - any director should have the right to attend meetings. However
 - i) a routine meeting between the NEDs and the auditors without any executive director present should be retained;

- ii) the Committee should say that for practical reasons it does not regard it as sensible for the full board to act as the audit committee unless it is a board of non-executives (albeit that in principle full board ultimately is the audit committee as the audit committee only has the right to make recommendations to it, not to take action independently).
- Rules on membership of audit committees for small companies should not be relaxed. If such companies have good reasons for not complying they can explain them in their compliance statement.
- Proposal at 4.7 of the Code to be dropped.

Maxwell

- 'and might have been avoided' to be dropped from 1.7. Additional sentence to be considered, making point that measures strong enough to combat every fraudster would severely shackle British industry.

Enforcement

- More emphasis to be placed on responsibility of shareholders for taking up with companies issues disclosed by compliance statements with which they are unhappy. Proposals should not be seen in context of self-regulation versus statutory regulation - Committee is rather proposing market-based regulation. Stock Exchange's role, through the listing agreement, is to ensure adequate provision of information so that shareholders can raise compliance questions with the company if they wish; it is not Stock Exchange's role to ensure compliance with the Code as such. Important role of press and analysts also to be acknowledged. Perhaps a good topic for the Chairman's preface.

The Code

- Free-standing version to be produced.
- Code not be redrafted in two parts, but those parts which will be capable of objective verification by the auditors to be identified in the report, and to be subject to audit endorsement. (APB to be requested to produce

list of those items it believes are suitable for audit endorsement, in time for any points of difficulty to be considered before final report sent to press.)

- Auditors not to endorse statements by companies in respect of parts of Code not capable of objective verification, but to be expected to take up (eg with audit committee) any parts of the statement with which they are unhappy. This will be a specific responsibility if the compliance statement is published as part of the directors' report. Accordingly
- 3.9 of the report should be amended so as to recommend that the compliance statement should be published as part of the Directors' Report. (Stock Exchange to consider whether this can be included in the listing obligation.)
- Code should not also be addressed to shareholders, as proposed by CBI.

Small companies

- Wording of 3.16 to be reconsidered. Need to stress that application of Code to small listed companies has been carefully considered and the Committee believes that it will bring benefits to them. In particular, point should be made in the context of small companies that NEDs are not on boards just to act as policemen, but they can make a very positive contribution to running the business. Possibly helpful to make clear that the chairman of a company who is not also its executive head may count as an 'NED', and indeed as an 'independent NED' provided he meets the criteria on independence.
- Majority of Committee not disposed to make significant concessions in respect of small companies. References which acknowledged that small listed companies 'might need more time' to implement the Code fully, or 'would need to ensure that the benefits of particular measures in the Code outweighed the costs' would need to be carefully drafted if they were not to provide a general escape route not only for measures which would involve some costs for small companies (appointing NEDs, installing an adequate system of internal control, and having it audited) but also for those which would not, such as disclosure of directors' remuneration. Small companies should disclose the extent of their compliance with the

Code to their shareholders. If shareholders and 'the market' are persuaded by the explanation then the small company will have no problems. Any worries that an excess of negative compliance statements by small companies might bring the Code into disrepute should be a matter for the review after two years.

Date of application

- Operative date for the listing requirement should be year-ends on or after 30 June 1993. Companies should however be encouraged to make statements before this on a voluntary basis. The two-year review should commence at the end of 1994.

The Board

Combined roles of chairman and chief executive (4.6 and Code 1.2)

- No change to be made, apart from possible adjustment to the reference to an appointed leader.

Make up of remuneration committee (4.34)

- No change.

Formal schedule of matters reserved to the board (4.19, 4.20, Code 1.4)

- CBI's point (that all matters are for the board unless they are expressly delegated) is right in principle. The Committee is in effect producing a list of items which should not be delegated and ensuring everyone is clear about it.
- 'Material guarantees' should be added to the list but the other suggestions go beyond the Committee's remit. Report should emphasise that the list is not intended to cover the full range of the board's duties.

Proposal that all directors should come up for re-election every 3 years (4.14, Code 2.3)

- Mixed views in Committee. Arguably beyond the Committee's remit. To be logged as a matter for the successor body.

Proposal that best practice on service contracts is three years' fixed or one year's rolling (4.33, Code 3.1)

- Again mixed views, and again concluded that matter should be logged as one for the successor body. Need for disclosure to be added to 4.33.

Disclosure of directors' pay (4.32, Code 3.2)

- Wording of Code 3.2 should be adjusted to make clear that 'full disclosure' of the emoluments of the chairman and highest paid director should include details of stock options (although not their notional value at the date of the accounts) and pension contributions. 'Pension contributions' should be mentioned along with stock options and stock appreciation rights in the second sentence of 4.32. The word 'complete' in the second sentence of 4.32 makes the second sentence inconsistent with the third and should be drafted out.
- More substantive changes on directors' pay (eg giving shareholders more opportunity to vote, or disclosing full details of every director's emoluments) should not be made without prior public consultation - two more subjects to be logged for the successor body.

Non-executive directors

Definition of independence (Code 2.2)

- Revised definition to be drawn up, based on 4.27 rather than 4.9.

Guidance on minimum number of NEDs

- Committee not in favour of guideline in PRO NED Code.

Nomination Committees (4.13, 4.24, Code 2.5)

- 'and their nomination' in Code 2.5 to be replaced by 'and both this process and their appointment'. PRO NED guidance to be checked.
- 4.24 to remain unchanged.

Audit Committees

- Report to make point that the interim and final accounts must be considered by the full board, and that the auditors should attend certainly for board consideration of the final accounts, and preferably for consideration of the interims as well.

Internal audit (discussed in paper CFACG(92)19)

- Committee content to see 4.31 of report strengthened along lines proposed by the Group Chief Internal Auditor of ICI, and also for the extract from the the Arthur Andersen booklet to be drawn on. Committee not however prepared to endorse a requirement for companies to establish an internal audit department.

Internal Control (4.26, 5.16, Code 4.2)

- Committee noted that consultation response was reasonably supportive. No difficulty about 4.2 remaining in Code. Subject to be referred to consistently as 'internal control', not 'internal financial control'.

Going Concern (5.18 to 5.23; Code 4.6)

- Body of report to acknowledge work in progress in APB. ?4.6 to remain in the Code but to be subject to a caveat?

The Company Secretary (discussed in paper CFACG(92)18)

- Subject to detailed wording, Committee favourably disposed to proposed addition to the Code (1.5).

- Again subject to detailed wording, Committee also favourably disposed to proposed additions to the body of the report, apart from the last two sentences of 4.21B, and 4.21D. 4.21C should be placed before 4.21A and 4.21B.

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21.9.92