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THE SOCIETY OF INVESTMENT ANALYSTS

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Copy for your
retention. I have
acknowledged.

N_{3/12}

Mr Nigel Peace
Secretary
Committee on The Financial Aspects
of Corporate Governance
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Moorgate Place
London EC2P 2BJ

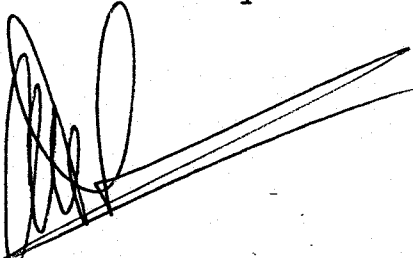
29 November 1991

Dear Mr Peace

The Financial Aspects of Corporate Governance

In reply to your letter of 31 July, 1991 to Mr Davis, I enclose
the Society's submission on the above.

Yours sincerely



A H Newman
Secretary General

Encl.

in Adria

copy for your records.

N_{15/1}

Members of the Council: C.C. Davis (Chairman), S.R. Boshell, C.J. Clark, G.J.J. Dennis, P.F. Diggle,
G.M. Fuller, P.J. Greenslade, L.F. Heasman, D.P. Johnson, R.D. Matthews, J. McGee, J.A. Miller, J.L. Parrott, T.V. Partridge,
R.D.T. Pringle, N.T. Ralston, P.H. Richards, M.A. Van Hus. Secretary General: A.H. Newman

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COMMENT BY
THE SOCIETY OF INVESTMENT ANALYSTS
ON
THE FINANCIAL ASPECTS OF
CORPORATE GOVERNANCE

November 1991

98/91

Members of the Council: C.C. Davis (Chairman), S.R. Boshell, C.J. Clark, G.J.J. Dennis, P.F. Diggle,
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THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE

The Society of Investment Analysts submits the following comments on the above document:

1. Nature of the Debate

The focus of attention on accounts and financial reporting (both factual and qualitative) is aimed at ensuring standards that 'provide users with information about the financial position, performance and financial adequacy of an enterprise'. (Accounting Standards Board) The SIA is cognizant that a primary objective of any company must be to provide financial information that is comprehensible, relevant, reliable and facilitates comparison.

To this end, the SIA welcomes the work being undertaken by the ASB, the IASC, the accounting institutes, the FRC under Sir Ron Dearing and the Auditing Practices Board.

However, at the corporate level, the focus of financial control is concerned with both internal control and external interface with shareholders and the public at large. It is for this reason that we feel that this subject must also be considered in relation to corporate leadership and governance, since board composition is a vital aspect for ensuring that financial control and reporting work adequately.

2. Corporate Structure

Composition of a board is an important element in the analysis of company financial control. A board is primarily concerned with the bigger picture encompassing policy objectives, senior staffing, overall direction, coordination, reporting systems, budgetary and financial control, leadership, accountability and shareholder relations. In this context, establishment of priorities is important.

Checks and balances at board level are therefore important. For this reason, we favour a separation of the role of Chairman and Chief Executive, and the appointment of non-executive directors some of whom may well have specialist knowledge so as to make a meaningful contribution in technical areas (e.g. finance). (This subject has been well studied e.g. Point of View No. 16 issued by Spencer Stuart). The non-executives have a vital role in asking the probing questions and demanding answers. Independence of mind in non-executives is important.

3. Definition of Financial Aspects

Financial aspects encompass both factual and qualitative data whether it be for internal or external consumption. Anything which impinges on financial and operations reports and the governance of a company is relevant. The interaction between non-executives and executives is important in ensuring that an objective view of a company is presented both with regard to current operations and future prospects.

But the limitations of company accounts has to be understood, both internally within a company and externally by users of published information. The board has a responsibility for ensuring objectivity in reporting but cannot be held responsible for the impact of unforeseeable exogenous factors.

4. Financial Data and End User

It follows that a board is the filter of financial information, a catalyst to provide data and a legal overseer to ensure compliance with legal requirements.

At the internal level, the board has the duty to ensure objectives are being met and set appropriately, and at the external level to ensure that dissemination of information is factually correct and qualitative statements fair and prudent.

5. Limitations on Meeting 'Expectations'

At the end of the day, companies in the private sector are in the risk-taking business and qualitative statements must be balanced, incorporating factual premises and value premises, the latter being reasonable in the circumstances. The factual data should however reflect best accounting practices.

6. The Important Role of Non-Executive Directors

The non-executives, working alongside the executives, have to set goals, monitor, establish priorities, set strategic goals, and ensure the company's well-being. The provision of short and long-term capital requirements is important.

The non-executives therefore have to be adequately informed, and monitor operational and financial results of the business against plans and budgets, taking remedial action when required. If necessary, they must be the catalyst to initiate change in the portfolio structure. It follows that an adequate flow and dissemination of financial information at board level is imperative, as are strong-minded and independent non-executives.

7. Role of External Auditors

External auditors have a limited role. A company's directors are responsible for preparing accounts and reports. The auditors must indicate that accounts are 'true and fair' - a qualitative statement.

8. The Importance of an Internal Audit Committee

We cannot stress enough the importance of a suitably staffed internal audit committee, composed of mainly or wholly non-executives. This should provide checks and balances on the executives, and strengthens the board accountability to shareholders. The role of the Chief Executive in relation to an internal audit committee requires careful consideration. Composition and terms of reference should lie (mainly) with the non-executives.

9. The International Dimension

The present debate on international standards (IASC) in our view increases the importance of an audit committee. Compliance with good practice becomes increasingly imperative as new standards and changes to existing standards are formulated.

10. Limitations on Choice

We welcome the nature and the magnitude of the debate on accounting standards. The establishment of standards will limit the choice in presentation of financial data and should facilitate and crystallize further the role of external auditors, while at the same time giving greater focus to the work of an internal audit committee.
