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29 July 1992

N. Peace, Esq
Secretary
Committee on the Financial Aspects of Corporate Governance
PO Box 433
Moorgate Place
London
EC2P 2BT

Dear Sir,

DRAFT REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE

I enclose my comments on the above Report issued on 27 May 1992. These comments are made in a personal capacity based on six years experience as the Financial Director and Company Secretary of Gaskell PLC, a small PLC listed on the London Stock Exchange. I felt that the Committee might appreciate some views from the "coal face" as it were to counter-balance submissions from the representative bodies and from FTSE 100 companies.

I would welcome any feedback you are able to give in response to comments you have received on the draft report and I would be quite prepared to expand upon my views if that was felt to be appropriate.

Yours faithfully,

J. C. Kay
Financial Director

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DRAFT REPORT OF THE COMMITTEE ON
THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE:

Comments submitted by J. C. Kay, FCA
c/o Gaskell PLC, PO Box 10, Lee Mill, Bacup, Lancashire OL13 0DJ

1. The Committee's terms of reference are tightly drawn and the draft Report addresses the terms of reference in a comprehensive and considered manner. However, many of the present shortcomings in financial governance are outside the terms of reference of the Committee and stem from present accounting standards and the nature of the audit report. It is very important that these areas are addressed directly, in addition to the introduction of a Code of Best Practice for corporate governance. Paragraphs **4.38** and **4.42** refer to these issues.

   The present shortcomings and inconsistencies stem from there being too many alternative possibilities under the current accounting standards and from the essentially subjective audit opinion of "true and fair". I would suggest that the final report highlights the fact that the Code of Best Practice will not be effective unless changes are made as follows:

   a) The Accounting Standards Board to urgently conclude its review of current accounting standards with the aim of reducing the possibilities for alternative accounting treatments.

   b) Consideration be given to the amendment of the traditional audit report of "true and fair" to a report which states that financial statements are "true and fair subject to the overriding accounting concept of prudence". I would suggest that this is what a third party user of accounts actually expects to be the case, but the subjectivity of the phrase "true and fair" leads to inconsistent treatment from company to company. Auditors will be able to exert a greater influence in favour of conservative financial reporting.

   If these points were not highlighted as a pre-condition for the success of the recommendations, then the structure for corporate governance which is created will be subject to the existing fundamental flaws.

2. There should clearly be some size criteria applied in the implementation of the Code of Best Practice. Clearly, what is appropriate for a multi-national corporation is not necessarily appropriate for a smaller listed company. For instance, at one extreme, as a practical necessity in order to operate an effective Board meeting, it will be important to have an audit committee. At the other extreme it is simply not required. It is clearly inequitable that the smaller PLC should suffer market stigma year by year simply because it has to provide a list of its non-compliance with a Code of Best Practice which is inappropriate to its circumstances. Clearly there should be a gradual evolution of compliance according to size.

3. Whilst companies should be encouraged to appoint non-executive directors, I would have thought that the choice of a non-executive director would be based on what the

individual can bring to the business based on his or her wider experience, rather than based on abilities in relation to financial control and reporting. The Report aims to give ultimate sanction for financial reporting to the non-executive directors who, if necessary, will have a forceful leader able to combat the powers of the Chairman. This, to me, rather diminishes the powers of an executive director and makes the role far less attractive. If the ultimate power is to reside with non-executive directors, then we shall all aspire to be non-executive directors.

The authority of a non-executive director should derive from institutional shareholders with whom he or she will be in regular contact. The ultimate sanction that a non-executive director has is to resign. A resignation or the threat of resignation of a respected non-executive director would surely given an adequate signal to the institutions. I would suggest that this is a better remedy than to formalise the board into distinct power groupings, as I imagine there is already enough creative tension on most PLC main boards.

4. Finally, a general point in relation to the standing of the accountancy profession. We have read recently of certain organisations "drinking in the Last Chance Saloon". I feel that the accountancy profession now has a window of opportunity to overhaul the mechanisms of corporate governance and the methods of financial reporting. The two are interrelated and the introduction of the Code of Best Practice alone without the financial reporting reforms suggested above is likely to fail. If these objectives are not achieved, the reputation of the profession will be deservedly diminished.

JCK\dmnm
29 July 1992