

Sir Adrian.
CAD-01231

IN CONFIDENCE

RECORD OF MEETING WITH PROFESSOR DAVID TWEEDIE, CHAIRMAN OF THE ACCOUNTING STANDARDS BOARD, ON 23 JULY 1991

Present:

David Tweedie
Sir Adrian Cadbury
Nigel Peace

1 Professor Tweedie said that he had been horrified, when he had arrived at the ASB, to hear the vitriolic comments that were being made about auditors. At the root of the problem was the auditors' relationship with the directors, and in particular the lack of independence stemming from the fact that they were appointed and paid by the board. If the auditors had a disagreement with the board and fell out, then there was a serious risk that the following year they would find the audit put out to tender and new auditors installed. So in the audit firm the 'commercial' view would prevail over the 'technical' view. He agreed with Sir Adrian that audit rotation was not the answer, because the auditors' accumulated experience of the business was extremely important for the success of the audit. For the same reason he did not support the proposal that the audit should be compulsorily put out to tender after a fixed number of years, with rules which made it impossible to dismiss the auditors whilst they were in office without the agreement of independent outsiders nominated to review the case. He did not see an easy answer, but the key was probably in the area of non-executive directors and audit committees, provided those concerned were of sufficient calibre and had sufficient independence.

2 Professor Tweedie said that he very much welcomed the setting up of Sir Adrian's Committee. He believed it would be very helpful to the ASB in establishing the right climate. The more independent the auditor, the easier the Board's task. The Board wanted to see auditors as independent professionals that did not see their task as helping management to get round the accounting rules. The Board felt vulnerable in the areas the Committee would be looking at.

3 Professor Tweedie continued that trust in the audit was crucial. Auditors had to be independent so that they could say what they thought without being fired or sued. One of the problems was the importance to an individual audit partner of retaining a major client. If that client was lost he risked losing half his workload and his position within the firm could be in jeopardy. Another problem was the 'creeping crumple': it was extremely difficult to stand out against a particular accounting practice if a company could point to another firm of auditors that had allowed it, or (worse) another office within the same firm of auditors. The Urgent Issues Task Force had been specifically established to try to stop bad precedents emerging. There was nothing more infuriating for a firm than to stand firm on a point of principle; lose the audit; and see the new auditors concede the point under some camouflage or other.

4 Professor Tweedie said that he would find it helpful to have the Committee's steer about the reporting of information on future prospects. This was a subject the ASB was unlikely to tackle for 2 or 3 years. He commented that he was concerned about the attitude of analysts in this area: he believed they were opposed to greater disclosure about future prospects because they gained their competitive advantage by acquiring such information behind the scenes. That came extremely close to insider dealing. Sir Adrian said that he had been comforted by anecdotal evidence that there was some movement of analysts to the institutions where they devoted more attention to how well companies were run.

5 Professor Tweedie said that he would also welcome the Committee's steer on issues such as

- greater narrative discussion of the figures in the accounts. The ASB was about to look at Management Discussion and Analysis documents in the US and he was unsure what the reaction would be. There was nothing similar on the continent and there was the question of how much competitive disadvantage UK companies would face if they followed the US route. On the other hand MD&As might be helpful to companies who were concerned, in a bad year, about the short-termism of the City;

- simplification of the report. Research into the views of the private shareholders of Scottish and Newcastle had shown that they had no understanding of the financial statements, but that they did like the Chairman's statement.

6 Professor Tweedie said that it would be helpful if the Committee supported 'The Future Shape of Company Reports' work. The ASB's work programme followed the agenda it set fairly closely, except that it had been steered away from reporting on future prospects. It would also be more conservative on asset revaluation, although it still anticipated a huge argument in that area. On disclosure of expenditure on research and development, marketing, training etc the Board had made the mistake of calling it 'discretionary expenditure' but were now looking to the title 'revenue investment'. Sir Adrian commented that he particularly liked the recommendations of 'The Future Shape' and the CIMA reports in this area. Expenditure on these items determined the company's ability to earn money in the future.

7 Professor Tweedie said that another topic he would be pleased for the Committee to consider was that of extended audit reports, which he supported. There was also the 'emphasis of matter' area. He believed that auditors should highlight problems, and where management itself had commented in the MD&A he did not see any difficulty in the auditor highlighting. He also believed that obscure notes in the accounts should be spelled out and made comprehensible.

8 Professor Tweedie continued that the profession was well paid and that it would kill the golden goose if its reports could not be relied on. There was just a short window of opportunity, whilst the economy was in recession, to do something about it. Sir Adrian commented that Neville Bain had told him that the degree to which the accounting rules could be bent was a positive disadvantage to him as chief executive.

9 Professor Tweedie said that he hoped the new regime of the Financial Reporting Review Panel, which came into operation on 1 October, would help to reform attitudes. Where the Court ordered accounts to be revised, the auditors who had agreed the original version would be in a serious position, right up to senior partner level. The question would be raised whether those

concerned were fit and proper persons to be a company auditor. Mike Likkiss, who was in favour of some examples being made, was worth speaking to on the subject.

10 Commenting on the situation in the USA, Professor Tweedie said that auditors did not have a notably greater degree of independence than in the UK, because they were still appointed by the board. On opinion shopping, the US had strong rules which required the provider of the opinion to talk to the incumbent auditor. This provided a strong safeguard.

11 Professor Tweedie suggested that the following would be useful people to speak to on the independence question:

John Stevenson, who retired as Technical Director of Touche
Ross about one year previously;

Derek Foster, who retired from Arthur Young about 2 or 3
years previously (contactable via the ICAS);

Keith Hamill of Guinness (Chairman of the CBI's Technical
Committee);

James Joll, Financial Director of Pearsons;

Donald Mann, THF

Ian Brindle, Senior Partner of Price Waterhouse

NDP

25 July 1991