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Dear Chris

FRC WORKING GROUP ON AUDITOR LIABILITY LIMITATION AGREEMENTS – CONSULTATION ON DRAFT GUIDANCE

Standard Life Investments is an indirectly wholly owned subsidiary of Standard Life plc. We manage funds on behalf of clients, including other members of the Standard Life Group as well as third parties, which amounted to £143.4 billion as at 31 December 2007. A significant proportion of these funds are invested in UK securities. Therefore, we have considerable interest in ensuring that the Working Group's Guidance is consistent with the best long-term investment interests of our clients. Accordingly, we welcome the invitation to comment.

We recognise that it is the Working Group's role to provide practical guidance regarding the implementation of the legislative provisions. Consequently, we understand that the Working Group will not make any specific recommendations, and that its remit does not extend beyond the said provisions. Notwithstanding, it is appropriate and important that it is made clear that there is no legal requirement of companies to utilise these permissive legislative provisions. That is to say that there is no legal or other requirement to enter into an auditor liability limitation agreement. This clarity could be achieved either within the guidance itself – possibly in the introduction – and/or in the related promotional material.

Let me now address the questions posed.

Question 1: Does the draft guidance meet the objectives summarised in paragraph 8?

The draft guidance appears to provide information which will be of practical assistance to auditors and directors. However, in our opinion, there is little in the way of practical assistance in the draft guidance for shareholders on how to apply the new legislation. To address this perceived deficiency, we suggest that the Working Group consult actively with the established investor representative bodies with a view to developing practical assistance for shareholders.

Question 2: Should the final guidance identify which methods of setting the auditor's liability are most likely to be acceptable in particular circumstances as proposed in paragraph 10, or simply set out the options as in the draft guidance?

With reference to the three options set out in Appendix B, the guidance should make clear that, in the normal course, shareholders will, subject to terms, only find the proportionality option acceptable. And, conversely, shareholders would find the monetary cap option unacceptable. Giving such guidance should be useful for companies and shareholders alike: it will help companies and shareholders to channel their respective resources into pursuing those options which are most likely to gain support.

It is noted that the options set out in Appendix B are not exhaustive. In the event a hybrid option is favoured then the guidance should suggest that the boards of companies should consult with their larger investors and have regard for their views before entering into the contract and/or putting it to shareholders for approval in general meeting.

Question 3: Does Section 3 of the draft guidance identity all of the main factors to be considered when assessing the case for an agreement, if not, what other factors should be considered?

Factors which will make it significantly more likely that we would approve a liability agreement are:

- A clear, convincing and non-boilerplate rationale to explain why such an agreement is in the best interests of the company and its shareholders.
- Shareholder agreement being obtained before the agreement is entered into.
- The company having an audit committee which comprises entirely independent non-executive directors.
- The liability agreement being available for inspection, preferably on the company's website.
- A commitment by the auditors to provide an enhanced audit report, which we envisage would be more discursive and informative than is currently the norm.
- A meaningful and tailored explanation of the basis on which the proportions of liability were determined.
- A proportionate reduction in audit fees to reflect the lower financial risk to auditors.

Factors which will make it unlikely that shareholders would approve a liability agreement include:

- The use of a monetary cap, either on a stand alone basis or as part of a hybrid arrangement.
- Concerns regarding the ability of the auditor to deliver a high quality audit.

We commend these factors for consideration.

Question 4: The guidance is intended to be equally applicable to public and private companies. Are there different considerations for private companies, and does the guidance address them adequately?

No comment.

Question 5: Are there any other procedural issues that should be covered in Sections 4 and 5 of the guidance?

- Whilst the 'principal terms' for approval by shareholders should provide a useful summary, it is the detailed terms which will ultimately prove conclusive. Therefore, we regard it as important that shareholders should be able to inspect the full agreement, preferably via the company's website, at all times. In addition, we suggest that it would be appropriate to include some 'catch all guidance', which would seek to ensure that the principal terms include 'all other such information which is relevant to enable shareholders to make a well-informed decision'.
- The guidance should clarify the processes pertaining to the limitation of liability of the audits of joint ventures and unincorporated entities which are consolidated. Transparency of the arrangements in this area is very important for investors if such entities are relevant to the presentation of a true and fair view of the group results and financial position.

- We are struck by the relative absence of guidance for audit committees, especially given their presumed important role in the process. The guidance should assist audit committees in reporting to investors about their approach to liability limitation agreements.
- Whilst we support the view that companies may wish to seek authorisation at the same time as proposing a resolution to reappoint the auditors (5.8), we should be concerned if these aspects became the subject of a bundled resolution. We suggest that this be referenced specifically in the guidance. Also, it is important to note that we should be concerned if, as an unintended consequence, the guidance results in engagement letters being put to a shareholder vote. This would be a detrimental outcome that would be of no benefit to any party. The guidance should guard against such an outcome.
- The limitation provisions which would apply following the appointment of a new firm of auditors could be especially important, bearing in mind the possible context of such an appointment. Shareholders should consider and approve in a timely manner the terms on which a new firm of auditors are appointed to fill a casual vacancy. We recommend that guidance be provided to ensure that timely approval of any liability limitation agreement is obtained from shareholders in such situations – preferably before the appointment becomes unconditional.

Question 6: Do you have any comments on the specimen principal terms, clauses and resolutions and notices in Appendices B to D?

No.

Question 7: Are you aware of any sources of information and advice that should be cross-referenced in the guidance?

Not at this stage, but we question whether it is wise to refer to such sources of information bearing in mind they may be amended following publication of the final guidance. It would seem inappropriate to unintentionally refer readers to information which is out-of-date. Hence, we suggest deletion of Appendix E should be considered.

Conclusion

The draft guidance is welcome but there are several important aspects that need to be addressed. In particular:

- providing practical assistance to shareholders;
- providing guidance to assist audit committees; and
- giving due emphasis and weight to the fact that there is no necessity for a company to enter into a liability limitation agreement.

We hope our comments will assist the Working Group in its continuing deliberations on this important subject.

Yours sincerely

Guy R Jubb
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Standard Life Investments