STATUTORY AUDIT SERVICES

Summary of a conference call with [✂] plc held on 25 January 2012

Background

1. [✂] plc (the company) was an insurance and pensions provider that operated in over 20 countries around the world. It was a FTSE 100 business (ranked in the top 50) and had operating profit before tax of £[✂] billion in 2011.

2. The company was formed about ten years ago following the merger of [✂]. One of the big four firms were former auditors of [✂] and another were auditors of [✂]. Following the merger, the former were selected auditors for the merged group. It had been the company's auditor for ten years.

3. The company had recently completed an audit tender process, following which it switched its auditor to another big four firm [✂]. The audit fee for 2011 was £[✂] million.

The Chief Accounting Officer's view

4. The Chief Accounting Officer (CAO), [✂], reported to the Group CFO, [✂]. The CAO was heavily involved in the company's audit process.

5. The CAO trained with [✂], a firm of chartered accountants in St Albans, and then worked for a big four auditor for six years before joining the company.

Relationships

Auditors

6. The audit was planned both centrally and on the basis of individual business units. Individual plans were cascaded upwards, and consolidated into broader plans (eg on a Europe-wide basis). Reviews and challenges took place at various levels. The company had a Financial Reporting Control Framework that set out the company's approach to design and implementation of the control environment. It also supported the necessary SOX 404 reports.

7. Audits were undertaken at local level, then cascaded upwards. There were weekly meetings between the auditors and management and a list of hot topics which were circulated worldwide to drive resolution. There was interactive discussion and multiple layers of contact between the company and the auditors, as the audit was delivered. Senior management ensured that it had a line of sight on all relevant issues.

Audit Committee

8. The ACC was involved and met the CAO regularly, around every two to four weeks, along with the Risk Committee Chair. This year, toward the year end, the Audit Committee met four times in three months—January for a first meeting, a further meeting to present progress and two final sign-off meetings for the Preliminary Announcement and Report and Accounts and for the 20-F Report.

9. The Audit Committee worked very hard and was an important source of challenge. Its meetings tended to last 3 to 4 hours. It had private sessions with both the internal and external auditor (ie without management present).

Resolution of audit issues

10. During the audit process, there was a pyramid of clearance meetings, to consider particular issues and judgements, and to ensure that management could review the key issues. The aim was to resolve any differences with the auditors. [✂]

11. Final audit clearance meetings were held at local and regional level and then with the Group CFO and CAO. Final presentations were made to the Audit Committee by both the auditors and management.

Auditor selection

Tender process

12. In 2011, the company's Management and Audit Committee considered it appropriate, as a matter of good corporate governance, to test the market. Neither had been dissatisfied with [✂] (who had provided a good audit service to the company); the idea was to test the market rather than necessarily replace [✂].

13. The company invited the big four to tender, since it thought they had the necessary geographic spread and accounting and actuarial skills. It had assessed the capability of mid-tier firms (based on desktop research) and decided not to invite them to tender: it did not think that they had adequate worldwide capabilities, in particular with regard to actuarial skills.

14. One big four auditor had decided not to take part in the tender process. It provided significant consulting services to the company, and since the company as a matter of corporate policy limited the amount of consulting services it purchased from its auditor, it did not wish to be considered for the audit role.

15. Accordingly, the other three big four auditors bid. A thorough appraisal followed over a two-month period. An Invitation to Tender was issued at the end of March/early April 2011, regional meetings followed, and final presentations were made in June. This process had to fit into the company's reporting cycle. It had a calendar year end. The company needed to have confidence in its auditor at both business unit level and group level. Accordingly the tender was specified at both local and group level.

16. Each firm made three presentations to the company's regional teams, which amounted to around 40 sessions in total across all the firms. Final presentations were made to the Audit Committee and the regional CFOs and senior group finance team. The company's non-executive directors were heavily involved (many of them were themselves ex-Finance Directors with large organizations). The company had strong relationships with all the big four firms and had to weigh up the loss of the preferred auditor providing non-audit services in selecting the preferred auditor as the auditors. The Audit Committee recommended which firm should be appointed.

17. The company comprised a large number of separate legal entities and was also an SEC registrant. Any auditor must be 'independent' for SEC purposes. Accordingly an audit firm might need some time to become independent after appointment.

18. The company had used the Boston Consulting Group to provide support to the tender process, but the majority of the work was carried out as part of the finance team's normal work. As the project was well planned, it could be done robustly in a short time period. Both the tender and auditor transition were disruptive processes, as the company needed to educate the audit teams about the company worldwide. Accordingly, it did not want to undertake these processes very frequently. The CAO suggested that in the company's case a tender process every five to ten years would be appropriate, although if issues were raised during the annual reappointment, an earlier tender might be appropriate.

19. The company announced its decision to change auditor in a press release. The decision was then to be ratified by its shareholders at the AGM. Whilst it did not explicitly ask shareholders for feedback on this proposal, the company held frequent discussions with its major shareholders and they had not commented on, or raised concerns about, the proposal. Accordingly, the company expected this to be agreed at the AGM.

20. [✂] had been successful due the overall quality of its team and their interaction with the company. It was felt that [✂] could provide the best overall support both now and in managing the wide range of change expected over the next two years. Overall [✂] was the strongest global team although other firms had stronger teams in some areas.

21. In terms of price, the three bids had been broadly similar. Since the company actively managed the amount of consultancy services it purchased from its auditor, [✂] would lose some consultancy business as a result of winning the company's audit. The CAO noted that the fees proposed by the bidders were all very close.

Auditor reappointment

22. Each year, the company undertook a formal assessment of the effectiveness of its auditor. It undertook a bottom-up survey of the audit team and what they did. It assessed the audit firm's relationship with other firms of auditors (who must take part in the overall audit, given certain states' requirement for joint audit); their scepticism and quality of work and interaction with executive and non-executive teams. Each year there might be areas for improvement in a particular area or business unit and action plans for these were developed with the audit team.

23. The reappointment was made on the basis of an Audit Committee recommendation. The scope of the audit would change slightly from year to year, both in terms of geography and the extent of what the auditor must do (in light of changing regulation). Equally, the company expected continuing improvements in efficiency.

24. Some states required joint audits. Whilst the company preferred a single overall auditor, some of its legal entities could and did choose their own auditor (such as certain funds in France). In the main, but not in every case, the other auditors were big four firms.

Fees

25. Fee negotiation was led by local teams around the world and, at a Group level, by the CAO. Each year, the company scoped changes to the audit and sought efficiencies (for example, by providing more information to the auditor and having better internal controls) and negotiated locally. The process was led by the CFO and CAO. A proposal was then submitted to the Audit Committee for ratification.

Audit quality

26. The company had no appetite for regulatory non-compliance. It had to comply with SEC and all other relevant regulation. Audit quality was not just a question of getting the numbers right, but ensuring appropriate disclosure and a robust control environment (including issuing a SOX 404 opinion). The company's in-house team had a large number of staff who had previously worked at the big four firms.

27. The company saw audit quality as comprising three elements. First was technical robustness and making the right judgements. The audit firm must be alert to current requirements and to future challenges such as Solvency II and IFRS phase II and be able to support the company in ensuring compliance and reporting in line with these new standards. Second was process delivery, in terms of understanding the risks, challenging appropriately, understanding the business and the applicable regulation. Good technical and interpersonal skills were important. Third was the ability to interact effectively with management teams across the world and the Audit Committee.

28. Management received information on the group (controls, reporting, management issues etc) via three means: *(a)* internal finance team reporting, *(b)* independent internal group audit and *(c)* independent internal group risk teams. The external auditors provided additional observations from their work across the group and from knowledge of how good practice was developing across the industry.