



**PRIVATE & CONFIDENTIAL  
MEMO**

**PRINCIPAL ASSESSOR REVIEW**

**From: Lisa Peto  
6285**

**Subject: 75253  
Complaint by Mr G Senior-Milne ACA  
regarding PricewaterhouseCoopers**

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I have been asked to review the assessment made by Mr Farren regarding the complaint received from Mr G Senior-Milne against PricewaterhouseCoopers who acted as auditors of Scottish Widows for the years ended 31 December 1998 and 31 December 1999 and produced group accounts for Lloyds TSB for the year ended 31 December 2000. Mr Senior-Milne's complaint is that PwC should have been aware of the contingent liability in respect of guaranteed annuity returns; that the contingent liability is material, not remote, and a note should have been made in the accounts. Unqualified audit opinions have been given in respect of Scottish Widows' audit and in respect of Lloyds TSB group accounts Mr Senior-Milne believes that a separate contingency note should be disclosed in the accounts.

Mr Senior-Milne relies upon the fact that Ernst & Young and the directors of Equitable Life were 'aware' of the problem in 1998 and, therefore, the directors of Scottish Widows and, therefore, PricewaterhouseCoopers should also have been aware of Scottish Widows' exposure at that time.

Furthermore, the EL court case should have 'set alarm bells ringing' for PwC and SW. Mr Senior-Milne says the EL directors would not have taken their case to court if they thought the chance of the contingency crystallising was remote.

I understand from Mr Senior-Milne's website that the EL court case was determined on 20 July 2000 when EL was told to meet the liabilities of the GAR holders in full.

The argument therefore seems to hinge on when SW's liability became more than 'remote'. If, at each year-end, there was only a less than remote probability that SW would have to transfer economic benefits to the GAR holders then no disclosure is required.

**1998 accounts**

FRS 12 came into effect for periods ended on or after 23 March 1999, and it does not appear from the 1998 accounts that SW adopted it early.

The only evidence put forward is that the EL originating summons to the High Court was dated 15 January 1999, and therefore, per Mr Senior-Milne, there

was more than a remote chance that both EL and SW would have to pay the shortfall on their GAR policies.

However, the action did not come to trial until 5 – 7 July 1999, and EL won the first stage of the action. It was only on appeal that the policyholders won, leading to the House of Lords decision, in July 2000, to make the £1.5bn payout.

At the time of approving the 1998 accounts (2 March 1999) the EL case was at an early stage, and had not yet gone to Court. There is insufficient evidence to compel the directors to disclose the issue, and, using the FRS 12 terminology, the probability of ‘transfer of economic benefit’ was remote; the EL action had not come to trial on 2 March 1999, and the court summons was only six weeks old.

### **1999 accounts**

By 31 December 1999 the court had found in favour of EL, but on 20 January 2000 the court of appeal reversed the decision. EL appealed to the House of Lords, but the Court of Appeal decision was upheld on 20 July 2000. SW’s 1999 accounts were approved on 16 February 2000.

SW could easily have taken the view that the outcome of the EL case was far from certain as the Court of Appeal had overturned the original decision, and that was all still subject to the House of Lords hearing.

The 1999 accounts include, on page 10, a paragraph entitled ‘guaranteed annuities’. This paragraph does not include numerical disclosures and states that all the guarantees give rise to liabilities which increase from year-to-year and therefore it is critical that SW has enough assets to meet its liabilities. The statement also states that SW does have sufficient assets. Mr Senior-Milne argues that this disclosure is meaningless and makes no mention of the quantum of the alleged contingent liability. Under FRS 12 it is permissible to disclose details of contingencies without mentioning the quantum if the quantum cannot be measured.

I also note that on pages 3 and 4, under the heading of ‘bonuses’ it states that under the terms of the merger with Lloyds TSB, the holders of the ‘with profits’ policies would be receiving higher terminal bonuses than would have been the case had the merger not happened. Based on estimated values at 31 December 1998, this amount would have been £1.3 billion. This appears to be the ‘additional account’ referred to in Mr Senior-Milne’s correspondence. The additional account includes the additional costs of meeting guaranteed benefits and any unexpected liabilities which may arise in the future.

There was still sufficient uncertainty and confusion at the time (with the original Court finding in EL’s favour, and the Court of Appeal finding against EL) for SW to have been compelled to make any greater reference to this issue than that on pages 3-4 and 10 of the 1999 accounts. I do not believe that, at the time the 1999 accounts were approved, there was a requirement to provide for this amount because the final judgment on the EL case had not been made.

## 2000 accounts

By the end of 2000 the liability had been provided for, and therefore the item is no longer a 'contingency'.

Note 49 on page 75 states that the Additional Account, with a balance £1.9bn was created on the acquisition of SW by Lloyds TSB. Of this balance, £1.3bn relates to any additional costs of meeting guaranteed benefits, including annuity benefits on transferred policies and for any unexpected liabilities which arise in the future.

In my opinion it is clear that the Group expects the £1.3bn will be the estimate, at 31 December 2000, of the cost of meeting these additional liabilities and no additional contingency note is required in 2000.

Additionally, I do not believe the figure of £1.5bn is material to the assets/liabilities of Lloyds TSB (of £218bn at 31 December 2000).

I should be grateful if you would advise Mr Senior-Milne of my opinion, by way of supplying him with a copy of this memorandum should you so wish.

LP/sh

03 March 2008