



28 December 2007

Our Ref: 75253 RF/sh

PRIVATE & CONFIDENTIAL
Mr G Senior-Milne

By email: graham@gmilne.demon.co.uk

Dear Mr Senior-Milne

75253: PricewaterhouseCoopers

With reference to your email of 2 December 2007 12:16 and your complaint that PricewaterhouseCoopers signed unqualified audit opinions when the accounts for Scottish Widows for the year ended 31 December 1998 and 31 December 1999 contained no reference to the effect of the guaranteed annuity returns, then I would comment as follows.

Scottish Widows' accounts for the year ended 31 December 1998.

The audit report was signed off on 2 March 1999 only six weeks after the originating summons in the High Court which you date as 15 January 1999. Therefore, as the action was in a very early stage I do not believe that without hindsight there was sufficient basis to compel the company to conclude that a contingency note about the guaranteed annuity return exposure was necessary.

Scottish Widows' accounts for the year ended 31 December 1999.

The 1999 accounts show that the audit report was signed on 16 February 2000 and, as you state in your email, the Court of Appeal ruled on the Equitable Life case on 22 January 2000. Whilst you believe there should have been a contingency note, having read the financial statements for the year ended 31 December 1999, then it would appear that although the words 'guaranteed annuity' have not been used, provision appears to have been made for the liability.

I base this conclusion on the following.

1. On page 10 of the annual report within the Chairman's Statement there is a comment on guaranteed annuities and towards the end of the second paragraph I read:

'We are satisfied that our position on guaranteed annuities is fully in accordance with the contract terms of these policies.'

All of the guarantees, whether pension or cash, give rise to liabilities which increase from year to year as bonuses are added. It is, therefore, critical that a company has the assets to meet its liabilities. Scottish Widows clearly has the assets to meet all its liabilities, including those in respect of guaranteed annuities. Furthermore, assets are held in such a way that they are well matched to the underlying annuity guarantees.'

2. Accounting policies, page 37.

'Fund for future appropriations.'

The fund for future appropriations comprises assets which are in excess of the levels allowed for in the technical provisions.'

Technical account, page 38.

The transfer to the fund for future appropriations is £1.9 billion, a marked increase over the previous year of £361 million.

On that basis, therefore, I am unclear as to why a contingency note on the guaranteed annuities would be required as there appears to be sufficient information to indicate that the current obligation under the GARS is provided for. I, therefore, do not agree that a contingent liability note is required.

Lloyds TSB Group accounts for the year ended 31 December 2000.

Following the acquisition by Lloyds TSB of Scottish Widows, note 49 on pages 74 and 75 deals with the acquisition of Scottish Widows and it would appear that the provisions for future appropriations are reversed as part of the fair value adjustments. However, in the final paragraph of column 1 it states:

'Under the terms of the transfer of Scottish Widows' business, as set out in the policy holder circular dated 19 November 1999, a separate memorandum account was created within the With Profits Fund on 3 March 2000 called the additional account with a balance of £1.7 billion. This account included £1.3 billion which is available to meet any additional costs of meeting guaranteed benefits including annuity benefits on transfer policies allocated to the With Profits Fund and any unexpected liabilities which arise in the future but relate (with certain exceptions) to the operations of Scottish Widows and its subsidiaries prior to 3 March. The assets allocated to the additional account includes certain hedged assets which are intended to protect the With Profits Fund against the consequences of a future fall in interest rates, including increases in the costs of meeting policy guarantees.'

Again, it would appear that the potential liability is provided for within the accounts and, therefore, I do not believe a separate contingency note is appropriate.

Overall, therefore, I do not believe there is sufficient evidence to indicate that the audit reports issued by PricewaterhouseCoopers on these financial statements is inherently incorrect in failing to qualify the opinion for lack of disclosure of a contingency for the GAR.

If you disagree with my assessment and/or have additional evidence you wish to bring to my attention regarding your complaint, then I would be grateful if you could respond to this letter within 30 days. Since I do not believe that there is a potential liability to disciplinary action, should I not hear from you within those 30 days then I will close my file on this matter accordingly.

Yours sincerely

A handwritten signature in blue ink that reads "Rayf" followed by a horizontal line.

Mr Ray Farren

Assessor

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