




**STANDARD LIFE**

**STANDARD LIFE INVESTMENTS**



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Dear Mr Hodgkinson

## AUDIT FIRM GOVERNANCE – SECOND CONSULTATION PAPER

We write on behalf of Standard Life plc, as a major UK listed company, and its wholly-owned subsidiary Standard Life Investments Limited, as a major institutional investor. Both companies welcome the opportunity to contribute to the development of an Audit Firm Governance Code ('the Code'). We support the fundamental principle that the Code is in place to "support choice in the listed company audit market by enhancing confidence in the regulated professional partnerships that perform such audits", but we recognise that it is one of several mechanisms, rather than the single means to support this choice. We also recognise that the success of the Code will depend on the quality of implementing it and reporting compliance against it.

At this time we are submitting our responses to the recommendations proposed in the Walker Review, and to the issues for consideration in the FRC's progress report and second consultation on the Combined Code. Given the areas of commonality addressed in these consultation documents, especially on the role of institutional shareholders and the strengthening of the Principles of Stewardship, we would reinforce our opinion that the final Code should, wherever possible, be consistent with these recommendations, and with the current Combined Code requirements regarding dialogue with institutional shareholders, and the need for boards of listed entities to be aware of the views, on all material matters, of their shareholders.

Standard Life Investments Limited, tel. +44 131 225 2345, a company registered in Scotland (SC 123321) Registered Office 1 George Street Edinburgh EH2 2LL

The Standard Life Investments group includes Standard Life Investments (Mutual Funds) Limited, SLTM Limited, Standard Life Investments (Corporate Funds) Limited and SL Capital Partners LLP. Standard Life Investments Limited acts as Investment Manager for Standard Life Assurance Limited and Standard Life Pension Funds Limited

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We note in particular that one of the disclosed cases for the Code is that "The Code can help relieve shareholders in listed companies of the need to become experts in private partnership agreements, professional ethics, quality control and auditing standards and other regulatory requirements in order to obtain assurance about how audit quality is achieved". Equally, it is of interest to us that a principle behind the development of the Code is that "it is targeted at shareholders in listed companies and contains principles related to their dialogue with audit firms". Our main comments are therefore related to these areas and focus on the following three Code Principles.

## **Engagement with shareholders**

### *Firm dialogue principle*

F1 – "A firm should have dialogue with listed company shareholders, as well as listed companies, about matters covered by the Audit Firm Governance Code to enhance mutual communication and understanding and ensure that it keeps in touch with shareholder opinion, issues and concerns".

### *Shareholder dialogue principle*

F2 – "Shareholders should have dialogue with audit firms to enhance mutual communication and understanding and with listed companies in relation to their appointment of auditors".

### *Informed voting principle*

F3 – Shareholders should make considered use of votes in relation to the appointment of auditors of listed companies.

## **Dialogue**

Overall, we support these principles. We see benefits in increased dialogue and engagement between institutional investors and an audit firm on the basis that it remains informed, focussed, objective and industry or issue generic where possible, rather than relating to a particular audit client/issuer matter. If engagement were to take place on a particular audit client/issuer matter, we believe that it would be legitimate if it related to information which is publicly available. Otherwise we are concerned that discussion on a particular matter may breach the auditors' duty of care to its client, as well as the issuer's communications responsibilities to its shareholders under the Listing Principles.

We believe that dialogue should focus principally on the audit firm itself, looking at, for example:

- the audit firm's risk management practices;
- provisions for audit/non-audit services being performed;
- rotation of audit partners;
- provisions for audit partners/managers accepting employment at audit clients/issuers;
- the audit firm's overall internal policies such as staff training or the content of audit procedure manuals.

We also believe that when institutional investors enter a dialogue with an audit firm, they should be doing so on behalf of all their shareholdings in the listed companies audited by that firm. Furthermore, we believe that the audit firm should report to the audit committees of its listed entity clients on the extent of the engagement it has had with institutional investors, the issues raised, and how it has addressed them.

#### **Audit firm appointment**

We believe that the appointment of an issuer's audit firm is a matter which is taken very seriously by the company, and is subject to full debate by the audit committee, taking account of executive views, and subsequently supported by comprehensive disclosure in the audit committee section of the Corporate Governance Report. Therefore, we believe that any dialogue between shareholders and issuers in relation to the appointment of auditors should focus on a discussion on the due process which took place, with the aim of seeking reasonable assurance that the process has been thorough and in line with appropriate professional guidance and standards.

#### **Role of non-executives**

We believe that appointing independent non-executives to an audit firm will strengthen audit firm governance, but it would be appropriate for the final Code to reinforce that they do not owe a duty of care to an audit firm's clients or to the client's shareholders. Equally, we believe that the final Code should clarify that the audit firm's clients or that client's shareholders have no role in the selection of the candidates considered for appointment, or in the final approval of the appointment and that it is not the audit firm's clients or that client's shareholders whose interests are represented by the independent non-executive.

### **Costs and Benefits**

We are keen to reinforce that the principles in the Code should not be finalised without proper consideration of their practical application and likely efficiency, effectiveness, added value and increased accountability. We would not support any increased costs of audit firm compliance with the Code being passed on to the firm's clients through increased fees.

### **Quality of compliance**

We believe that it would be consistent with recent corporate governance proposals for there to be some formal regulatory means of reviewing statements of compliance with the Code, and, subsequently for public reporting of audit firm statements which did not comply with the Code. It is not clear whether this review and reporting activity should be carried out by the professional body by whom the firm is regulated, or by some other body, as the firm's activities covered by the compliance statements would extend beyond those addressed by work of the Audit Inspection Unit.

We hope that the above comments contribute to the finalisation of the Code. Please contact either of us if you wish to discuss any our comments further.

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& General Counsel  
Standard Life plc

Jonathan Cobb  
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Corporate Governance  
Standard Life  
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