

**FRC WORKING GROUP ON
AUDITOR LIABILITY LIMITATION AGREEMENTS**

**CONSULTATION ON DRAFT GUIDANCE
SUMMARY OF RESPONSES**

Introduction

The FRC Working Group consulted on the draft guidance between December 2007 and March 2008. 35 responses were received, including 14 from audit firms and their professional bodies, eight from investors and their representative bodies and eight from what could broadly be described as corporate interests. Of the five remaining responses, three were from the legal profession, one from LIBA, and one from an individual. The list of respondents is at [Annex A](#).

The consultation document asked seven questions about the draft guidance. These are listed at [Annex B](#), and the main issues raised in the responses to each question are summarised below.

Responses to the consultation questions

Question 1: Does the draft guidance meet the objectives summarised in paragraph 8 of the consultation document?

25 respondents answered this question. They divided into three groups: those who felt that the draft guidance largely met the stated objectives; those who felt that, while it met the stated objectives, these objectives were too narrow; and those who felt that it failed to meet the stated objectives in one or more respects.

The main issues raised in response to this question were:

- There were divergent views on the merits of entering into a liability limitation agreement, and the extent to which the guidance should encourage or discourage their adoption;
- There were differing views on the extent to which the guidance should set out the public policy arguments why auditors should be able to limit their liability, and the background to the legislative change;
- Directors sought further reassurance that entering into an agreement was not inconsistent to with their duties to the company as set out in the Companies Act 2006, and further advice on the company-specific issues to be considered when assessing the case for an agreement.

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liability are most likely to be acceptable in particular circumstances, or simply set out the options as in the draft guidance?

33 respondents answered this question. Two-thirds of these respondents considered that the guidance should indicate that, at least for companies with institutional investors, proportionality should be the preferred option. Many of the remaining respondents considered that, while the guidance should not indicate a preference, it should highlight the position taken by investor bodies in support of proportionality. There was less consensus on the extent to which the guidance should cover other approaches to limited liability.

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

29 respondents answered this question, with the majority taking the view that Section 3 needed to provide further guidance on one or more of the following issues:

- the public policy arguments why auditors should be allowed to limit their liability;
- other factors to be considered by directors, including whether doing so was consistent with their new statutory duties; and
- the factors to be considered by shareholders when deciding whether to approve an agreement.

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?

21 respondents answered this question. Views were divided between those that felt that the draft guidance distinguished adequately between public and private companies where it was necessary to do so, or that the considerations were essentially the same for all classes of companies, and those that felt that the different considerations for, and processes to be followed by, private companies should be more clearly distinguished.

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

26 respondents answered this question, of whom six considered that the draft guidance dealt adequately with procedural issues and had no further comment. The three issues raised most frequently by other respondents were:

- A need for more guidance on how liability limitation agreements should be implemented in a group of companies;
- The timing of seeking approval for an agreement, and the link to the engagement letter; and
- The information to be provided to shareholders to enable them to decide whether to approve an agreement.

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

The draft guidance contained two sets of draft specimen principal terms to be used when following the 'proportionality' approach. Of the 17 respondents who commented, the majority considered that only one set of principal terms should be included in the final guidance, with a general preference for the shorter Version 2. A number of respondents considered there was a need for these specimen terms to be simplified further.

A minority of respondents considered that the final guidance should not include specimen principal terms for either or both of the other approaches contained in the draft guidance (the 'fixed cap' and 'fair and reasonable only' approaches).

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

18 respondents answered this question. A number of respondents questioned the value of cross-referencing to other sources of information and advice in the guidance itself as these would rapidly become out of date, and suggested instead that other source material should be accessible through the FRC website.

Financial Reporting Council
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ANNEX A

RESPONDENTS

Note: This list does not include respondents who requested that their response be treated as confidential

1. Association of British Insurers
2. Association of Chartered Certified Accountants
3. Baker Tilly LLP
4. BDO Stoy Hayward LLP
5. British Bankers' Association
6. CBI
7. Chartered Institute of Management Accountants
8. Chartered Institute of Public Finance and Accountancy
9. City of London Law Society
10. Deloitte & Touche LLP
11. Ernst & Young LLP
12. GC100
13. Grant Thornton LLP
14. Hermes Equity Ownership Services Ltd
15. Hundred Group of Finance Directors
16. Institute of Chartered Accountants in England and Wales
17. Institute of Chartered Accountants of Scotland
18. Institute of Chartered Secretaries and Administrators
19. Institute of Directors
20. International Corporate Governance Network
21. Investment Management Association
22. Kingston Smith LLP
23. KPMG LLP
24. Law Society
25. Law Society of Scotland
26. London Investment Banking Association
27. Local Authority Pension Fund Forum
28. Mazars LLP
29. National Association of Pension Funds
30. National Grid plc
31. PriceWaterhouseCoopers LLP
32. Quoted Companies Alliance
33. Railpen Investments
34. Charles Smith
35. Standard Life Investments

ANNEX B

CONSULTATION QUESTIONS

Question 1: Does the draft guidance meet the objectives summarised in paragraph 8 [of the consultation document]? *They were to:*

- *explain what is and is not allowed under the 2006 Act (Section 2 and Appendix A of the draft guidance);*
- *set out some of the factors that will be relevant when assessing the case for an agreement (Section 3 of the draft guidance);*
- *explain what matters should be covered in an agreement, and provide specimen clauses for inclusion in agreements (Section 4 and Appendices B and C of the draft guidance); and*
- *explain the process to be followed for obtaining shareholder approval, and provide specimen wording for inclusion in resolutions and the notice of the general meeting (Section 5 and Appendix D of the draft guidance).*

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 [of the consultation document], or simply set out the options as in the draft guidance?

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

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?

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

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

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