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10 August 2010

Dear Steven,

Practice Note 20: Consultation Draft - The audit of insurers in the United Kingdom (Revised) May 2010

This letter and the appendix set out our written comments on the Practice Note (PN) 20 consultation draft published in May 2010 (the 'consultation draft').

We welcome the update of PN 20 to reflect the recent changes in International Standards on Auditing (UK and Ireland) (ISAs), legislation and regulation. We believe it is important for auditors of insurance companies to have access to the updated guidance by the time Clarity ISAs are effective from 15 December 2010.

We believe that overall, the majority of the significant new or revised requirements of ISAs that affect insurers have been reflected in the draft PN 20. There are a number of points (primarily points of detail) where we believe the guidance in the consultation draft should be amended and we set these out, together with some other suggested drafting changes in the Appendix to this letter. We believe the illustrative opinions on the regulatory returns set out in Appendix 1 of the Practice Note should be updated to be consistent with the requirements of ISA (UK and Ireland) 700 "The auditor's report on financial statements" (Revised and Redrafted) insofar as those requirements are relevant to such opinions. To that effect we suggest amending Appendix 1 templates 1.2, 1.3 and 1.4, 1.6, 1.7 and 1.8. Examples of suggested amendments to achieve this are attached to the Appendix to this letter.

If you have any queries regarding this response please contact Mike Vickery at the above address.

Yours sincerely

PricewaterhouseCoopers LLP

Appendix - PwC Comments on Practice Note 20: The audit of insurers in the United Kingdom (revised) – Consultation Draft, dated May 2010

Practice Note 20 Reference	Comment
Para 21	The reference to “The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008./410)” should be replaced with a reference to the “The 2008 Accounts and Reports Regulations” as previously defined in paragraph 19(b).
Page 16 – paragraph following the heading “THE AUDIT OF FINANCIAL STATEMENTS”	<p>The first sentence of this paragraph reads “This Practice Note applies to those ISAs that are effective for audits of financial statements for periods ending on or after 15 December 2010. This includes audits of the financial statements of insurers.”</p> <p>We believe this sentence either be deleted or reworded to more appropriately read “This Practice Note contains guidance on the application to the audits of financial statements of insurers of those ISAs that are effective for periods ending on or after 15 December 2010”.</p>
Para 42	Amend as follows: “...APB’s Ethical Standard for Auditors 2 (Revised) – F financial, business, employment and personal relationships.”
Page 18 - Second shaded box with extracts from ISA 210	Amend as follows to quote the ISA accurately: “... The auditor shall agree the terms of the audit engagement with <u>management or those charged with governance, as appropriate.</u> ”
Para 43	<p>Suggest deleting last bullet point of the paragraph.</p> <p>This bullet differs from the three previous ones in that it does not deal with insurance specific matters of legal or regulatory obligation. In, addition, the general requirements to be included in engagement letter regarding disclosure of information to auditors would cover this area (paragraph 6(b) of the ISA). There may be many matters of which an auditor of an insurer may expect to be made aware and it would appear anomalous to make only one of them a contractual term</p>

Page 220 ISA 220 – Objective	<p>The sentence: “Reference should also be made to ISQC (UK and Ireland) 1...” is not a direct extract from the Objective section (or any other element) of the ISA and so should not be included within this or any other shaded box. Suggest deleting this sentence and inserting a separate shaded box quoting from paragraph 2 of the ISA as follows:</p> <p>“Under ISQC (UK and Ireland) 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:</p> <ul style="list-style-type: none"> (a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and (b) The reports issued by the firm or engagement partners are appropriate in the circumstances (paragraph 2)”
Para 83	<p>This paragraph states that the assessment of material significance must be made “without making any assumptions about the information available to the FSA</p> <p>We note that paragraph A26 of the ISA states “... a minor breach which has been corrected by the regulated entity and reported (if appropriate) to the regulator, and which from the evidence available to the auditor appears to be an isolated occurrence, would not normally give the auditor reasonable cause to believe that it is or may be of material significance to the regulator.” This implies knowledge of reporting to the regulator may be a relevant factor in the auditor's consideration and therefore consideration should be given to rewording paragraph 83 to reflect this.</p>
Para 107	<p>This paragraph deals with the undertaking in paragraph 4(3) of Schedule 2 to the AAB and refers to reporting to the Council of Lloyd's “when... a) The authorisation of the syndicate could be withdrawn ... d) the continuous functioning of the syndicate may be affected”</p> <p>The requirement under paragraph 4(3) of Schedule 2 to the AAB refers to entity rather than syndicate and thus applies to the</p>

	underwriting agent as well as to the syndicate. Thus subparagraphs (a) and (d) should refer to underwriting agent as well as syndicate.
Para 123	This paragraph deals with the need to “involve auditor’s experts” and refers, inter alia, to involving “a tax specialist to assist the consideration of provisions for corporation and other taxes included in an insurer’s financial statements”. We believe this paragraph should be amended to make it clear that where a tax specialist is involved in the assessment of the accounting for taxation (for example the correct application of accounting standards dealing with taxation) they may fall to be considered as possessing expertise in the field of accounting and so would not fall within the definition of an auditor’s expert.
Para 112	This paragraph states that “Recognised accountants may fail to discharge their duty ... if they wait until giving their formal opinion on the financial statements of the syndicate...”. Recognised accountants will be giving formal opinions on the financial statements of underwriting agents as well as syndicates and thus this paragraph should refer to this as well.
Para 128 and Para 179..	These paragraphs refers to the service providers’ “Independent Accountant’s Report”. The service providers’ report is an “Independent Service Auditors’ Report” and the wording of these paragraphs should be amended accordingly.
Para 182	Last bullet point: “Where liabilities of insurers ...”
Para 183	Suggest including management’s expert definition: “A management’s expert is an individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.”
Para 184	We believe that it could add clarity to be specific that a management expert could be internal or external.

Para 185	<p>Suggest adding text as indicated: “In assessing the competence, capability and objectivity of a management’s actuarial expert <u>and the appropriateness of that expert’s work as audit evidence</u>, the auditor has regard”</p> <p>Suggest adding the following paragraph:</p> <p>“Further guidance regarding the use of the work of management’s experts is set out in paragraphs A37 to A48 of ISA (UK&I) 500”</p>
Page 71 - ISA 520: Analytical procedures extracts from ISAs	In addition to the extract from ISA 315 which deals with preliminary analytical procedures it would also appear appropriate to quote from ISA 520 paragraphs 5 and 6 which deal with substantive and final analytical procedures.
Para 209	<p>Suggest adding:</p> <p>A misstatement is defined at paragraph 4(a) of ISA (UK and Ireland) 450 as “A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework”</p>
Para 219	We suggest deleting paragraph 219 as considerations regarding the audit of derivative and other financial instruments are not insurance specific and no specific guidance is given other than referring the reader to the ISA.
Para 220	Suggest deleting the words “Both when applying EU-IFRSs or UK GAAP”.
Para 231 (b)	Amend: “...related party transactions <u>relationships</u> , and transactions,... ISA 550 (UK and Ireland) <u>550</u> ”
Para 239	<p>Suggest including:</p> <p>“ISA (UK and Ireland) 620 applies to auditor’s responsibilities relating to the work of an individual or organization in a field of expertise other than accounting or auditing, when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence. It does not extend to Situations where the engagement</p>

	<p>team includes a member, or consults an individual or organization, with expertise in a specialized area of accounting or auditing, which are dealt with in ISA (UK and Ireland) 220. Paragraph A1 of ISA (UK and Ireland) highlights that expertise in a field other than accounting or auditing may include expertise in relation to such matters as the actuarial calculation of liabilities associated with insurance contracts.</p>
Para 241	<p>When determining the degree of reliance that may be placed on the firm's quality control systems when assessing an internal expert's capabilities and competence Paragraph A13 of the ISA highlights that the extent of reliance will vary with circumstances. We believe this should be highlighted in the Practice Note as, as currently drafted, it could be interpreted that reliance may be total in all circumstances.</p> <p>A suggested revised wording is set out below:</p> <p>"Where the actuary is an internal expert (i.e. a partner or staff, including temporary staff, of the auditor's firm or a network firm), the auditor will be able to rely on its firm's quality control systems (unless information provided to the auditor suggests otherwise). The extent of reliance will vary with circumstances but, may impact the assessment of the actuary's capabilities and competence, objectivity, adherence to regulatory and legal requirements and the agreement and evaluation the actuaries work."</p>
Para 245	<p>Suggest adding:</p> <p>"Paragraph A1 of ISA (UK and Ireland) highlights other areas of expertise that auditor's experts might possess. Those of particular relevance to the audit of insurers may include:</p> <ul style="list-style-type: none"> • The valuation of complex financial instruments, land and buildings, intangible assets, assets acquired and liabilities assumed in business combinations and assets that may have been impaired. • The actuarial calculation of liabilities associated with employee benefit plans.

	<ul style="list-style-type: none"> • The interpretation of contracts, laws and regulations. • The analysis of complex or unusual tax compliance issues.”
Para 255	This paragraph states that “Syndicates are not required to maintain statutory equalisation provisions”. This sentence implies that syndicates have the option to maintain equalisation provisions which is not correct. Syndicates are not permitted to set up equalisation provisions and the wording should be amended to reflect this.
Para 257	This paragraph states that “inherent uncertainty is also relevant to syndicate underwriting year accounts” Inherent uncertainty applies to annual accounts as well and the wording of this paragraph should refer to this.
Para 258	This paragraph includes requirements for the auditor to report by exception for Underwriting Accounts but includes no such requirements for Annual Accounts. The wording should be amended to refer to these requirements for Annual Accounts.
Para 260	On the third line “identify” and “test” should be “identifies” and “tests”.
Paragraph 287	<p>This paragraph states “reliance on analytical review techniques is normally appropriate in relation to, for example, the segmental information provided within the regulatory return”.</p> <p>We do not believe there should be a presumption that analytical review techniques will be the most efficient or effective way to obtain sufficient appropriate evidence. We therefore suggest “is normally” be amended to “may be”.</p>
Para 306	<p>The format suggested for the audit report follows the previous version of ISA 700 which has now been superseded by ISA 700 (revised). As such we believe the structure of the report should be aligned with ISA 700 (revised) as set out below:</p> <p>“...c) Separate sections, appropriately headed, dealing with:</p>

	<p>(i) Respective responsibilities of the insurer and its auditor, and</p> <p>(ii) The basis of the auditor's opinion. <u>Scope of the examination of the Forms, the statements and the valuation report[s]</u></p> <p>d) Opinion on the Forms, the statements and the valuation report[s]</p> <p>e) <u>Matters on which we are required to report by exception:</u></p> <p>f) The signature of the auditor, and</p> <p>g) The date of the auditor's report.</p>
Para 310	Suggest including: "..., following the principles in ISA (UK and Ireland) 705 and 706...."
Para 319	For the reasons set out in our comments on paragraph 287 we suggest "is normally" be amended to "may be" in this paragraph.
Illustrative Examples of Auditor's Reports – Appendix 1.2 – 1.4	Please see Attachment 1 which represents a suggested amended version of Appendix 1.2 – Auditors' Report Composite Insurer. We have included suggested amendments to bring it in line with the requirements of ISA (UK and Ireland) 700. Similar amendments should be made to the opinions for life and general insurers in Appendices 1.3 and 1.4.
Illustrative Examples of Auditor's Reports – Appendix 1.6 – 1.8	Please see enclosed Attachment 2 which represents a suggested amended version of Appendix 1.7 – Closed year of account. We have included suggested amendments to bring it in line with the requirements of ISA (UK and Ireland) 700. Similar amendments should be made to the opinions in Appendices 1.6 and 1.8.
Illustrative Examples of Auditor's Reports – Appendix 1.7 and 1.8	The list of examples reports includes 1.7 closed year of account and 1.8 Run- off year of account. The appendix should state that these relate to underwriting year accounts
Illustrative Examples of Auditor's Reports – Appendix 1 – 1.2,1.3, 1.4, 1.5 and 1.6	<p>Examples of Auditor's Reports 1.2, 1.3, 1.4, 1.5 and 1.6 are proposed to be signed by 'Registered auditor'.</p> <p>"Audit reports" as defined in the Audit Regulations are required by paragraph 3.16 of those regulations to contain the designation "Statutory auditor(s)".</p> <p>However, where work does not fall within the</p>

	definition of an audit (as, prima facie would be the case for regulatory returns) the Audit Regulations are unclear as to whether the auditor should sign as “statutory auditor”, “registered auditor” or some other designation such as chartered accountants. We suggest the APB consults with the ICAEW on this matter if it has not done so yet to seek clarification as to how the regulatory reports should be signed.
Illustrative Examples of Auditor’s reports	The example reports should contain an example for syndicate annual accounts.

Attachment 1

1.2 – REGULATORY REPORT: COMPOSITE INSURER

.....[COMPOSITE INSURANCE COMPANY LIMITED]

[Global business/UK branch business]

Financial year ended 31 December 20xx

Independent auditor's report to the directors pursuant to rule 9.35 of the Interim Prudential Sourcebook for Insurers ('IPRU(INS)')

We have examined the following documents prepared by the insurer pursuant to the Accounts and Statements Rules set out in Part I and Part IV of Chapter 9 to IPRU(INS) the Interim Prudential Sourcebook for Insurers, GENPRU the General Prudential Sourcebook and INSPRU the Prudential Sourcebook for Insurers ('the Rules') made by the Financial Services Authority under section 138 of the Financial Services and Markets Act 2000:

- Forms [1 to 3, 10 to 32, 34, 36 to 45, 48, 49, 56, 58 and 60], (including the supplementary notes) on pages [...] to [...] ('the Forms');
- the statements required by IPRU(INS) rules 9.25, 9.26, 9.27 and 9.29 on pages [...] to [...] ('the statements'); and
- the valuation report[s] required by IPRU(INS) rule 9.31[(a)] on pages [...] to [...] (the valuation report[s])

We are not required to examine and do not express an opinion on:

- Forms [46, 47, 50 to 55, 57, 59A and 59B] (including the supplementary notes) on pages [...] to [...];
- the statements required by IPRU(INS) rules 9.30, 9.32, 9.32A and 9.36 on pages [...] to [...]; and
- the certificate required by IPRU(INS) rule 9.34(1) on pages [...] to [...].

Respective responsibilities of the insurer and its auditor

The insurer is responsible for the preparation of an annual return (including the Forms, the statements and the valuation report[s]) under the provisions of the Rules. **[The requirements of the Rules have been modified by [a] direction[s] issued under section 148 of the Financial Services and Markets Act 2000 on200X [and200X].** Under IPRU(INS) rule 9.11 the Forms, the statements, and the valuation report[s] are required to be prepared in the manner specified by the Rules and to state fairly the information provided on the basis required by the Rules.

The methods and assumptions determined by the insurer and used to perform the actuarial investigation as set out in the valuation report[s] are required to reflect appropriately the requirements of INSPRU 1.2 [and 1.3].

It is our responsibility to form an independent opinion as to whether the Forms, the statements, the valuation report[s] meet these requirements, and to report our opinion to you. In accordance with IPRU(INS) rule 9.35(1A), to the extent that any document, Form, statement, analysis or report to be examined under IPRU(INS) rule 9.35(1) contains amounts or information abstracted from the actuarial investigation performed pursuant to IPRU(INS) rule 9.4, we are required to obtain and pay due regard to advice from a suitably qualified actuary who is independent of the insurer.

Scope of the examination of the Forms, the statements and the valuation report[s]

The examination was conducted in accordance with Practice Note 20 'The audit of insurers in the United Kingdom (Revised)' issued by the Auditing Practices Board. The examination involves obtaining evidence about the amounts and disclosures in the Forms, the statements and the valuation report[s] sufficient to give reasonable assurance that the Forms, the statements and the valuation report[s] are free from material misstatement, whether caused by fraud or error and comply with IPRU(INS) rule 9.11. This includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Forms, the statements and the valuation report[s]. The evidence included that previously obtained by us relating to the audit of the financial statements of the insurer for the financial year. It also included an assessment of the significant estimates and judgments made by the insurer in the preparation of the Forms, the statements and the valuation report[s].

Opinion on the Forms, the statements and the valuation report[s]

In our opinion:

- (i) the Forms, the statements and the valuation report[s] fairly state the information provided on the basis required by the Rules [as modified] and have been properly prepared in accordance with the provisions of those Rules; and
- (ii) the methods and assumptions determined by the insurer and used to perform the actuarial investigation as set out in the valuation report[s] appropriately reflect the requirements of INSPRU 1.2 (and 1.3).

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Rules require us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our examination have not been received from branches not visited by us; or
- the Forms, the statements and the valuation report[s] are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations we require for our examination.

Chartered Accountants
Date

Address

Attachment 2

1.7 – LLOYD'S SYNDICATE – CLOSED YEAR OF ACCOUNT

Syndicate underwriting accounts contain no surround information other than the managing agent's report

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SYNDICATE XYZ- 200X CLOSED YEAR OF ACCOUNT

We have audited the syndicate underwriting year accounts for the 200X year of account of syndicate [XYZ] for the three years ended which comprise [state the primary financial statements such as the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement, the Statement of Total Recognised Gains and Losses], [the Statement of Accounting Policies] and the related notes. The financial reporting framework that has been applied in their preparation is the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008, the Lloyd's Syndicate Accounting Byelaw (No 8 of 2005) and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of the managing agent and the auditor

As explained more fully in the managing agent's responsibilities statement set out on page [] the directors of the managing agent are responsible for the preparation of the syndicate underwriting year accounts and for being satisfied that they give a true and fair view.

Our responsibility is to audit the syndicate underwriting year accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the Syndicate Underwriting Year Accounts

An audit involves obtaining evidence about the amounts and disclosures in the syndicate underwriting year accounts sufficient to give reasonable assurance that the syndicate underwriting year accounts are free from material misstatements, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the syndicate's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors of the managing agent; and the overall presentation of the syndicate underwriting year accounts.

Opinion on syndicate underwriting year accounts

In our opinion the syndicate underwriting year accounts:

- give a true and fair view of the [profit /loss] for the 200X closed year of account;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice;
- have been prepared in accordance with the Lloyd's Syndicate Accounting Byelaw (No. 8 of 2005); and
- have been prepared in accordance with the requirements of the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Syndicate Accounting Byelaw (No8 of 2005) we are required to report to you if, in our opinion:

- proper accounting records in respect of the syndicate have not been kept by the managing agent; or
- if the underwriting year accounts are not in agreement with the accounting records.

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John Smith (Senior statutory auditor)

*for and on behalf of ABC LLP,
Chartered Accounts and Statutory Auditor
Location
Date*