



### **Practice Note 20 (Revised): The Audit of Insurers in the United Kingdom**

ICAEW welcomes the opportunity to comment on the *Practice Note 20 (Revised): The Audit of Insurers in the United Kingdom* published by Financial Reporting Council on 25 October 2016, a copy of which is available from this [link](#).

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## MAJOR POINTS

1. We welcome the Financial Reporting Council's (FRC) initiative to revise and update Practice Note (PN) 20. There have been very significant legal and regulatory changes within the insurance industry since the last update in 2011; providing additional contextual material and guidance on applying international auditing standards to auditing financial statements and regulatory returns are helpful and necessary to ensure consistency in audits performed and audit opinions issued.
2. Solvency II which came into force on 1 January 2016 and the related PRA rules establish a comprehensive new prudential regime and require annual public solvency disclosures by directive in the form of a Financial and Solvency Condition report (SFCR) and linked quantitative reporting templates (QRTs), as well as periodic reporting to the competent supervisor. The PRA requires those returns to be subject to external audit and the revised PN includes guidance on the application of ISAs (UK) on those engagements. Non-directive firms continue to comply with solvency requirements set by the PRA and with the related reporting regime.
3. We have a number of points we would like to draw the FRC's attention to. Our main concerns are around sections 6 and 7 of the revised practice note which details the requirements of reporting on public Solvency II reports for Solvency II ('directive') firms.
4. SFCRs are prepared in accordance with a special purpose financial reporting framework as defined by ISA (UK) 800. The SFCR also include a series of QRTs which are also prescribed in regulation and by PRA rules. The PRA audit however does not include the complete SFCR or QRT package; there are exclusions from the scope of the external audit. The rules set out the elements of the SFCR which are "relevant" for the purposes of the audit and the circumstances in which some items are excluded from the scope. For example, there are exemptions for elements of the disclosures relating to the SCR when an insurer uses a full or partial internal model and for group information prepared and disclosed on a sectoral basis.
5. Para 46 of Section 6 of the practice note gives a list of items that are in or out of scope of auditable information. Although the list appears to be complete we believe that for sufficiently precise clarity regarding of what is in or out of scope, the FRC should provide appendices to the document explicitly identifying the elements of the SFCR representing the out of scope items. Additionally the illustrative opinions in section 7 do not adequately identify out of scope items. If unchanged this lack of clarity on what is not subject to audit could lead to these reports not complying with ISA 700. The failure of properly identifying these out of scope items means that the FRC risks audit firms concluding that the illustrative reports in the PN are not fit for purpose and therefore it is not appropriate to follow them. This would likely lead to inconsistency in practice in addition to creating a significant expectation gap for users of those reports. We strongly urge the FRC to amend the illustrative auditors' reports in section 7 of the practice note to explicitly identify items out of scope of the external audit.
6. We also note that there are a number of areas where the PN indicates that auditors should consider the implications of certain items for the Solvency II audit report. We believe that it will benefit no one if each audit firm makes its own decisions in such areas, leading to inconsistency of approach. The purpose of the PN is to provide guidance to auditors and one of the key areas in which it can do this is to seek to achieve consistency in the auditor's report. Therefore we recommend that the FRC explicitly states whether these items should or should not be included in the reports.

7. Examples of the above point include the following:

- Para 50 of Section 6 regarding the transitional measure on technical provisions notes “The auditor therefore considers the implications for the form of report”. The FRC provides some wording regarding this issue in Appendix 2 to the illustrative audit reports but notes that “The auditor may therefore consider whether to include some or all of the additional narrative in the body of the audit report”. The issue regarding this transitional measure will be common to the audit of all insurers who make use of it. The practice note implies that the audit opinion should include a limitation of scope qualification. We strongly believe that the FRC should decide how the transitional measure is dealt with in the auditor’s report. We recommend that the transitional measure is explicitly excluded from the scope of audit in the auditor’s report in the same way as information derived from an internal model SCR. We do not believe it will be beneficial to the user to refer to a ‘limitation of scope’ in respect of this item. Users need reports they understand and can rely on; having a standard limitation of scope qualification relating to information that the PRA supervisory statement explicitly says should not be audited is not helpful.
  - Para 57 of Section 6 regarding capital add-ons contains “The auditor considers the adequacy of the disclosure in the SFCR, and considers the implications for the form of report”. This issue will be common to the audit of all standard formula firms for the first two years of Solvency II’s implementation. We do not consider it necessary for the auditor to refer to the potential for capital add-ons as a matter of course in their report during the two year transitional period. Capital add-ons are approved by the PRA therefore they form part of the framework auditors perform their audit against. This framework explicitly permits non-disclosure of capital add-ons during the transitional period.
  - Appendix 1 to the illustrative audit reports in section 7 contains text on the legal framework underlying the SFCR and notes “The auditor may consider whether to make reference to this information in the auditor’s report”. The FRC should provide guidance as to whether such reference should be made and the form of words that would be used in those circumstances.
  - Appendix 2 and Note 1 to the illustrative reports in section 7 details relevant approvals, waivers or supervisory determinations and states that “The auditor may consider whether to include some or all of the additional narrative in the body of the audit report”. We believe that the listed documents (approvals, waivers, modifications and supervisory determinations) should be included in the auditors’ report as they form integral part of it and they are relevant to the audit.
8. The ‘sectoral information’ does not fall within the scope of ‘Other information’ in the illustrative audit report for groups. As this information is not subject to audit it would appear to fall within the ISA 720 definition of other information. Paragraphs 62-63 of section 6 of the practice note should clarify the status of the sectoral information as other information and this should be reflected in the illustrative reports.
9. In section 7 the practice note provides illustrative reports for auditors based on insurers’ different circumstances. There are examples for solo insurers using the standard formula or the partial/full internal model and for group insurers using the partial/full internal model. The FRC should provide an illustration for group insurers using the standard formula as well.
10. The recently published FRC Bulletin with a compendium of financial statements audit reports under ISAs (UK) replaces previous Bulletin 2010/2 which contains fewer illustrative reports and, in particular it does not have any for insurers, including friendly societies. Given the separate legislative regime that applies to friendly societies we strongly recommend that an FRC illustrative opinion for friendly societies financial statements should be included in the revised PN 20.

11. We believe that it would be helpful if the FRC suggested a template for the Statement of management's responsibilities in the SFCR to enable a more consistent approach and disclosure among insurers.
12. In section 6 para 3 reference to guidance for the audit of non-directive firm regulatory reports should be corrected to Section 8 (number "8" is missing).
13. In section 7, Auditor's report example C: An auditor's report on relevant elements of the SFCR, In Independent Auditor's report: Group, partial/full internal model – 'Opinion' paragraph on page 115 template S.22.01.22 is included in both the 'in scope' and 'out of scope' sections.
14. Lloyd's no longer require an auditor's report on personal accounts; therefore if this is confirmed as permanent by Lloyd's, paragraphs 56 to 59 section 5 should be deleted.
15. In the Definition of Terms at the back of PN20 the definition for UK GAAP makes reference to the ABI SORP, this should be deleted and replaced by a reference to FRS103.

## RESPONSES TO SPECIFIC QUESTIONS

**Q1: Overall do you agree that with the revisions to the Practice Note, if not why not?**

16. We agree and support the FRC's efforts in revising and updating the practice note. However we do have significant concerns regarding the illustrative opinions as described above in points 5-13.

**Q2: Do you agree with the proposed revisions to section 4 on the Audit of Financial Statements, including:**

- The removal of the 'copy out' text from the ISA's (UK)?
- The extent of insurance sector specific guidance on the application which has been provided?

17. We do agree with the proposed revisions in section 4.

**Q3: Does the new material in section 6, which covers the audit of Solvency II Pillar 3 disclosures (SFCRs), provide sufficient guidance on the application of ISAs 800 and 805 to these engagements?**

18. We do believe that the new material in section 6 provide sufficient guidance on the application of ISAs 800 and 805 to the audit of Solvency II Pillar 3 disclosures.  
However we believe that specific guidance on first year transition would be beneficial. For example paragraphs 4-8 of section 6 of the practice note the FRC could clarify the standards to follow where ISAs 800 and 805 are adopted early for the audit of Solvency II regulatory returns for periods commencing prior to 1 January 2017.

**Q4: Do you agree with the content and the structure of the illustrative reports for SFCR audits which are set out in section 7?**

19. We have significant concerns regarding the illustrative reports in section 7 which we have detailed in point 5-10 above. Therefore we do not agree with the content and structure of these illustrative reports.

**Q5: The illustrative auditor's reports in section 7 contain a mandatory Emphasis of Matter paragraph which describes the special purpose financial reporting framework, in accordance with ISA (UK) 800. Do you:**

- Agree with the content of the EoM?

- **Believe there is a need for additional disclosure – for example in respect of the non-disclosure of the existence of PRA imposed capital add-ons in accordance with the Solvency II member state option?**

20. We believe that the suggested content for the ISA (UK) 800 EoM is sufficient as described. For further details on our view on capital add-ons please see the second bullet point in point 7 above.

**Q6: Do you agree with the revisions to sections 8 and 9 on the audit of regulatory returns for non-directive firms, including the illustrative reports?**

21. We have no comments on these sections.

**Q7: Does the revised PN20 contain sufficient guidance and contextual material in respect of the audit of friendly societies? If not, are there specific areas where this could be enhanced or improved?**

22. Please see our comments in point 10 above.

**Q8: Do you agree with the FRC's proposal to withdraw Practice Note 24: The Audit of Friendly Societies in the United Kingdom, having incorporated relevant material into PN20? If not, why not?**

23. We agree with the FRC's proposal to withdraw Practice Note 24.