

FEEDBACK PAPER ON THE CONSULTATION DRAFT OF PRACTICE NOTE 20 “THE AUDIT OF INSURERS IN THE UNITED KINGDOM (REVISED)”

Introduction

- 1.1 In May 2010 the Auditing Practices Board (APB) issued for public comment a Consultation Draft of a further revision to Practice Note 20 “The audit of insurers in the United Kingdom (Revised)”. The current version of PN 20 (Revised) was issued in January 2007.
- 1.2 The Consultation Draft gave effect in the PN to:
 - the issuance of the clarified ISAs; and
 - changes in the legislative and regulatory framework.
- 1.3 In addition new or enhanced guidance was included with respect to the following:
 - Auditing accounting estimates;
 - Evaluation of misstatements identified during the audit;
 - The auditor’s report (including the reporting of equalisation provisions); and
 - The illustrative example of various regulatory auditor’s reports that are addressed to the FSA or to Lloyd’s.
- 1.4 The six respondents to the consultation are listed in the Appendix. In addition APB staff undertook outreach activities with staff at Lloyd’s of London, the FRC’s Audit Inspection Unit and the staff of the Board for Actuarial Standards (BAS). In addition FSA staff had provided input on the Consultation Draft prior to its issuance.

Overall satisfaction with the proposals

- 2.1 Although commentators made a number of detailed recommendations with respect to the proposed text of the proposed Practice Note they expressed a high degree of general satisfaction with the proposed Practice Note. The outreach activities with Lloyd’s and BAS and the Audit Inspection Unit also revealed general satisfaction with the proposals.

Change in APB policy regarding the publication of illustrative auditor’s reports.

- 3.1 Prior to the finalisation of the revised PN 20 the APB decided that all of its illustrative auditor’s reports relating to financial statements should be published in a Compendium Bulletin rather than in individual Practice Notes. Bulletin 2010/2 was published in December 2010 and includes the following four illustrative auditor’s reports relating to the financial statements of insurers:
 - 17. Publicly traded insurer with a standard listing preparing financial statements under UK GAAP and having equalisation provisions

- 18. Lloyd’s syndicate – annual financial statements
 - 19. Lloyd’s syndicate – underwriting year accounts – closed year of account
 - 20. Lloyd’s syndicate – underwriting year accounts – run-off year of account
- 3.2 Auditor’s reports on regulatory returns and on interim net profits continue to be published in Appendix 1 of PN 20 and are discussed further in paragraphs 5.1 and 5.2 below.

Materiality

- 4.1 The most significant issue raised by commentators related to the appropriateness and adequacy of the proposed guidance relating to materiality in the context of the requirements of ISA (UK and Ireland) 320. The basic issue is that insurance companies typically have large balance sheets in comparison to the amount of reported income. Therefore, if profit is used as a benchmark for determining materiality, the amount of audit work on the balance sheet based on such a materiality would be high. Some commentators contended that income should not be the benchmark for determining materiality, preferring to use a balance sheet measure such as net assets as a benchmark.
- 4.2 A public report of the Audit Inspection Unit (AIU) had criticised an auditor of a listed insurer for using 2% of equity as a determinant of materiality, which amounted to 20% of profit before tax. The AIU contended that the auditor should have used a lower materiality in order to audit the income statement effectively.
- 4.3 The guidance relating to ISA 320 was extensively revised. Guidance that had been developed for the revision of PN 19 in respect of banks was incorporated into PN 20 because it addressed the issues relating to the determination of materiality where an entity’s balance sheet is considerably larger than its income statement. The guidance that was originally proposed was revised to ensure that it was fully aligned with the requirements and guidance in ISA (UK and Ireland) 320.

Conforming the structure of auditor’s reports to regulators, with the requirements of ISA (UK and Ireland) 700

- 5.1 A number of commentators suggested that the format of the auditor’s reports to regulators should align more closely with the format and headings of the revised ISA (UK and Ireland) 700.
- 5.2 Following discussion of this issue the APB decided not to align the reports as suggested because:
- a) ISAs (UK and Ireland) do not apply to regulatory returns (they apply to financial statement audits);

- b) As the reports are private reports the two part opinion is not of relevance;
and
- c) The FSA has indicated that they do not want the reports restructured in this way.

Merging PNs 20 “Insurance” and 24 “Friendly Societies”

- 6.1 One commentator recommended that when PN 20 is next revised that consideration should be given to consolidating it with PN 24 “The audit of Friendly Societies in United Kingdom”. They noted “There is a lot of overlap between the two practice notes and any friendly society specific guidance could be dealt with in an appendix”.
- 6.2 The APB concurred with this suggestion which will be implemented at the time of the next revision.

RESPONDENTS TO CONSULTATION DRAFT OF PN 20

Accountancy body

- 1) The Institute of Chartered Accountants in England & Wales

Auditing firms

- 2) Deloitte LLP
- 3) Ernst & Young LLP
- 4) KPMG LLP
- 5) Mazars LLP
- 6) PricewaterhouseCoopers LLP