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Dear James,

FRC Consultation on Exposure Draft: Practice Note 20 (Revised): The Audit of Insurers in the United Kingdom

1. I am writing in response to this consultation on behalf of the Association of Financial Mutuals.
2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not for profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of £16.4 billion, and employ nearly 30,000 staff¹.
3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses².
4. We welcome the work undertaken by FRC to ensuring audit standards are consistent with wider regulatory requirements, and are pleased to support the general direction of the proposed amendments to PN20.
5. This response does not address AFM's view on whether mutual insurers should be subject to an audit requirement on their Solvency returns, and in particular for those mutuals that are Directive, an audit of the SFCR under Solvency II. We have made separate representations on this to HMT and the PRA as part of their consultations, and have previously flagged our

¹ ICMIF, <http://www.icmif.org/global-mutual-market-share-2013>

² Financial Services Act 2012, section 138 K: <http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted>

concerns to FRC. Our comments on this Practice Note with respect to Solvency returns are made in the context that audits are now or will be required, setting aside any reservations we may have in this respect.

6. We do not comment on those questions where we consider the audit profession is better placed to dictate given the legal and regulatory framework within which it operates, for example, on the form of reports. However, we are generally supportive of the proposals to exclude from the scope of audit those areas of Solvency II that would be difficult and costly to audit, for example, those elements linked to an internal model or partial internal model. Equally we support the pragmatism in scoping the audit of Group Solvency II returns, including only limited assurance being required for amounts included for non-insurance entities within the Group.
7. We are concerned that any audit burden imposed on AFM members, many of whom have limited resources, is contained within reasonable and practical constraints.
8. We provide responses to questions on the following pages. We look forward to discussing further the issues raised by our response.

Yours sincerely,



Chief Executive
Association of Financial Mutuals

Response to questions raised in the consultation

a) Overall do you agree with the revisions to the Practice Note, if not why not?

Overall we agree with the revisions noting that a substantial amount of material from the discontinued Practice Note 24: The Audit of Friendly Societies in the United Kingdom, has been carried across. We fully support this material being retained since, whilst friendly societies and other insurers have much in common with respect to their operating, regulatory, risk and control environments, they are subject to distinct legislation. We note the inclusion of the relevant Friendly Societies Act references in Section 2, for example, and consideration being given against each ISA in Section 4, for example ISA 550, Related Parties, refers to friendly societies being caught by sections 62-69 of the Building Societies Act concerning directors' loans and transactions.

Section 2 does not, however, explicitly refer to the position of those mutual insurers constituted as Industrial and Provident Societies. UIA Insurance Limited, for example, an AFM member, is in this category. These mutual entities are subject to the Companies Act 2006 financial reporting requirements by virtue of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008. The Practice Note might refer to this also for completeness.

Under ISA 700: The Auditor's Report on Financial Statements, reference is made to the AFM's recommendation that mutual insurers adhere to the Annotated UK Corporate Governance Code, and the implications for reporting by the auditors. In fact, the AFM has re-positioned itself in the last year to represent medium and small mutuals and not-for-profit insurers, with many larger mutuals now affiliated with other trade bodies such as the ABI. It is still the case that the AFM recommends adherence to the Annotated Code for its members though it is no longer a condition of membership. As far as we are aware, the members which have left the AFM will continue to voluntarily apply the Code (and our annotated version), though their compliance with the Code will not be overseen by the AFM. It might therefore be appropriate to re-draft paragraph 152 of the Exposure Draft to refer to mutual insurers that voluntarily adhere to the UK Corporate Governance Code or the Annotated version published by the AFM rather than emphasising *ab initio* the AFM's recommendation.

Section 8 of the Exposure Draft refers to the fact that Non-directive friendly societies are not required to have their regulatory reports to the PRA audited. Clearly those mutual insurers constituted as companies limited by guarantee or as Industrial and Provident societies will still be caught by an audit requirement. It might be worth spelling this out in the text as Section 8 will apply for those mutuals.

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

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

No comment.

c) *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?*

No comment.

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

No comment.

e) *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 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?*

Our members are unlikely to be comfortable with disclosure in respect of any imposed capital add-ons as there is unlikely to be sufficient allowance for providing appropriate context to accompany it.

f) *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?*

Please refer to our comments under a) above.

g) *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 could this be enhanced or improved?*

Please refer to our comments under a) above.

Within the “definition of terms” on page 133 of the Practice Note, a “Friendly Society” is defined as “a voluntary mutual organisation whose main purpose is to assist members financially during sickness, unemployment or retirement, and to provide life assurance.” We suggest this is worth updating to reflect the contemporary role of the sector: as a minimum, we suggest removing “voluntary” and state “whose purpose often includes assisting members...”, to reflect the wider role now played by some societies.

h) *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?*

Please refer to our comments under a) above.