Independent auditor's report to the members of Direct Line Insurance Group plc

Opinion on the financial statements of Direct Line Insurance Group plc

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2013 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("**IFRSs**") as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The financial statements comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and Parent Company balance sheets, the consolidated and Parent Company cash flow statements, the consolidated and Parent Company statements of changes in equity and the related notes 1 to 40 on the consolidated financial statements, and the related notes 1 to 16 on the Company financial statements. The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the consolidated financial statements, in addition to complying with its legal obligation to apply IFRSs as adopted by the European Union, the Group has also applied IFRSs as issued by the International Accounting Standards Board ("**IASB**").

In our opinion the Group financial statements comply with IFRSs as issued by the IASB.

Going concern

As required by the Listing Rules we have reviewed the Directors' statement on page 102 that the Group is a going concern. We confirm that:

- we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate; and
- we have not identified any material uncertainties that may cast significant doubt on the Group's ability to continue as a going concern.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

Risk	How the scope of our audit responded to the risk
The methodology and assumptions used in setting insurance reserves The determination of the value of the insurance reserves requires significant judgment in the selection of key assumptions and methodology. Management makes significant judgement in respect of the trends in bodily injury claims frequency and severity, the propensity for large claims to settle as PPOs, the Ogden discount rate consultation and other regulatory developments.	We have tested the design and implementation and operating effectiveness of the key controls over the end to end reserving process engaging our internal actuarial specialists where appropriate. In addition we have: • tested the completeness and accuracy of the underlying data used; • considered the suitability of the methodology used in setting insurance reserves; and • challenged management's key assumptions and judgements against industry benchmarks. Our work included assessing whether the reserving methodology has been applied consistently across periods. We have also performed work to understand the sensitivity of insurance reserves to changes in key assumptions and methodology.
The valuation of investments including complex financial instruments and their accounting treatment in accordance with IAS 39 and IFRS 13 The valuation of financial investments held at fair value utilises a range of inputs. Many of the inputs required can be obtained from readily available, liquid market prices and rates. Where observable market data is not available, for example, when determining the valuation of investment property, estimates must be developed based on the most appropriate source data and are subject to significant judgement.	We have performed audit procedures over the valuation and accounting of investments held by the Group. We have tested the design and implementation and operating effectiveness of the key controls over the investment valuation process. On a sample basis we have tested their valuation at the year end. We also performed a review of sources and systems used by the Group for valuation and compared valuations to those obtained from more than one independent source or recalculated them. We also engaged our valuation specialists where appropriate and checked that the disclosure requirements of IAS 39 and IFRS 13 were appropriately addressed. We have also tested the Group's compliance with the accounting rules for complex financial instruments.

Risk	How the scope of our audit responded to the risk
Transformation projects There is a risk that the business transformation programmes undertaken by the Group could negatively impact the internal financial reporting control environment, in particular in areas of the business where there has been significant headcount reduction or new processes and procedures. There is a risk that there may no longer be an appropriate level of review and adequate segregation of duties.	We have tested the design and implementation and operating effectiveness of key business processes that have been subject to change. We have tested to determine whether appropriate segregation of duties exists within the Group's system of internal controls. For example, the procedures included an assessment of the wider implementation of the new claims system.
Reinsurance asset valuation The valuation of the reinsurance asset in respect of the ceded part of the insurance reserves requires significant judgement to reflect the counterparty risk exposure to long-term assets arising from PPOs.	We have tested the design and implementation and operating effectiveness of the key controls over the reinsurance asset valuation process. We have challenged management's key assumptions over counterparty risk and the calculation methodology, including a comparison of the underlying credit ratings for key reinsurance counterparties to independent sources. We have also considered the consistency of the approach with the prior year.
Revenue recognition International Standard on Auditing 240 (UK and Ireland) state this risk must always be treated as significant. We focus on the completeness of the revenue recorded in the financial statements and the flow of premium information from the underwriting systems to the financial reporting ledger.	We have tested the design and implementation and operating effectiveness of the key controls over revenue recognition, focusing on the flow of information from the underwriting systems to the financial reporting ledger. In addition, we performed substantive analytical testing procedures on the gross and unearned premium balances.

The Audit Committee's consideration of these risks is set out on page 67.

Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the Group to be £40 million, which is below 10% of normalised pre-tax profit, and below 1.5% of equity. Pre-tax profit was normalised by taking the average pre-tax profit from ongoing operations, which excludes the impact of discontinued activities and the transformation costs, for current year and the previous two years to exclude the effect of year-on-year volatility from our determination.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £800,000, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

The scope of our group audit was determined by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we focused our group audit scope on the audit work at three primary operating locations the UK, Italy and Germany.

Four entities at these locations were subject to a full audit, a further two were subject to an audit of specified account balances where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the Group's operations at those locations. These six entities represent the principal business units and account for 98% of the Group's net assets, 99% of the Group's revenue and 95% of the Group's profit before tax. They were also selected to provide an appropriate basis for undertaking audit work to address the risks of material misstatement identified above. Our audit work at the three locations was executed at levels of materiality applicable to each individual entity which were lower than Group materiality.

At the Parent Company level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

The group audit team followed a programme of planned visits that has been designed so that the Senior Statutory Auditor visits each of the locations where the group audit scope was focused at least once a year.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made or the part of the Directors' remuneration report to be audited is not in agreement with the accounting records and returns. We have nothing to report arising from these matters.

Corporate governance statement

Under the Listing Rules we are also required to review the part of the corporate governance statement relating to the Company's compliance with nine provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements 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. We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team, strategically focused second partner reviews and independent partner reviews.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

David Rush (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
25 February 2014