INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

ISSUES PAPER

ON THE ROLES OF AND RELATIONSHIP BETWEEN THE ACTUARY AND THE EXTERNAL AUDITOR IN THE PREPARATION AND AUDIT OF FINANCIAL REPORTS

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Issues Paper on the relationship between the actuary and external auditor and in the preparation and audit of financial reports

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Introduction

1. The IAIS recognises the importance of the application of actuarial expertise and the role of external audit within the context of financial reporting by an insurer to the supervisor, and as part of an insurer's overall governance system.[1] Because the supervisory process relies heavily upon financial reports, both the actuary and the external auditor are important within a supervisory framework.

2. The IAIS Insurance Core Principles (ICP) make numerous references to both actuaries and the external auditor. The following ICPs include references to the responsibilities of the actuary or external auditor, or both:

- ICP 1: Conditions of effective insurance supervision
- ICP 7: Suitability of persons
- ICP 9: Corporate governance
- ICP 10: Internal control
- ICP 12: Reporting to the supervisor and off-site monitoring
- ICP 13: On-site inspection.

3. The IAIS believes that the roles of the actuary and the external auditor, and the relationships between them and with the supervisor, are enhanced by:

- a clear description of their respective roles and responsibilities
- effective communication between them, where appropriate.

4. At the international level there is currently no comprehensive source of information or guidance to insurance supervisors regarding the relationship between the actuary and the external auditor and the communication between the two and with other stakeholders involved in the financial reporting process, within the context of the preparation and audit of financial reports of an insurer (although certain jurisdictions have produced such guidance).

5. This paper describes the roles of and relationships between the actuary and the external auditor, and their relationship with the supervisor, in the preparation and audit of an insurer's financial reports used by supervisors (which generally includes both general-purpose financial statements and other reports required by the supervisor). An understanding and clarification of these roles and relationships will help set insurance supervisors' minimum expectations of those roles and relationships within the supervisory process, as well as enhancing the relationships themselves.

6. There is currently no international auditing or actuarial standard which specifically deals with the relationship between the actuary and the external auditor. Whilst addressed primarily to insurance supervisors, this paper may also be useful to the auditing and actuarial professions and the insurers that engage them. Valuable input has been received from both professions in the development of this paper.

7. Although there is no international auditing standard which covers the relationship between the actuary and the external auditor, two International Standards on Auditing (ISAs) consider the role of an expert within the context of the audit and are of relevance:

- ISA 500 *Audit evidence* (December 2008) deals with the use by the auditor, as audit evidence, of information prepared by an expert employed or engaged by the entity (“management’s expert”). This auditing standard is relevant to the external auditor’s use of the work of the actuary employed or engaged by the entity (the "insurer's actuary").

[1] See also the joint IAIS/OECD *Issues Paper on Corporate Governance*, July 2009.

- ISA 620 *Using the work of an auditor's expert* (December 2008) establishes standards and provides guidance on using the work of an expert in gathering audit evidence for the purpose of developing an audit opinion regarding a financial report. This auditing standard is relevant to the external auditor's use of actuarial expertise (the "auditor's actuary") within the audit.[2]

Scope

8. This paper describes good practice regarding the roles of and relationships between the actuary and the external auditor and the relationships between them and the insurance supervisor. The paper also reiterates or elaborates on positions set out in other IAIS literature regarding relevant IAIS requirements or expectations. As the main focus of this paper is with respect to the preparation and audit of financial reports, it is acknowledged that some aspects of these roles and responsibilities could be discussed at greater length within a different context. These may be the subject of further work by the IAIS in the future.[3]

9. It is not the intention of this paper to impose requirements upon either the actuary or the external auditor regarding their professional roles and the professional relationship with each other or with the supervisor.

10. Financial reports may be prepared on different bases, including but not limited to, general-purpose financial statements, regulatory reports, capital adequacy and other special purpose reports. Actuarial expertise is generally required in the estimates and actuarially calculated financial values, such as technical provisions, included in such financial reports.[4]

11. The financial reports within the scope of this paper are those prepared by an insurer which

- include estimates or financial values calculated using actuarial expertise,
- are subject to an external audit, and
- are required by the supervisor.

12. The actuary referred to in this paper is an actuary who provides an opinion about a financial report or any of its parts that is used for supervisory purposes or who provides information to and supports management in its determination of values included in a financial report used for supervisory purposes. The actuary performing such a role can be either employed by the insurer (or affiliated company) or contracted by the insurer or a person or body responsible for the governance of the insurer, and may be referred to as the 'insurer's actuary'.[5] The actuary serving in these roles may serve a role similar to the management's expert as described in ISA 500, or for providing a professional opinion (outside the external audit process) relating to one or more financial items in the financial report. Other actuarial roles with respect to an insurer or for a financial report or a professional opinion are not addressed in this paper unless otherwise stated.

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[2] Various other International Standards on Auditing issued by the International Federation of Accountants (IFAC) are relevant to the audit of insurers' financial statements, and are available on IFAC's website at: www.ifac.org.

[3] For example, the relationship between the supervisor and the external auditor.

[4] The actuary may contribute to other reports on which the auditor is not required to express an opinion. Such reports are not within the scope of this paper.

[5] While the focus of this paper is on the actuary responsible for the actuarial functions described here, other actuaries may be involved in providing support. For example, an actuary in a business unit may provide relevant information or recommendations to an actuary in an insurer's corporate department, who may take these recommendations or modify them. As a result, multiple sets of actuaries may be involved in the actuarial calculation and review function within a company or a company group. As such, references to the insurer's actuary generally also relate to all actuaries involved supporting this work.

13. This paper discusses the insurer's actuary in a functional capacity and not individual actuaries' responsibilities within an insurer, for which different jurisdictions may have specific requirements. Depending on the jurisdiction and type of report, the insurer's actuary who provides assistance in and input into the preparation of a financial report and the insurer's actuary who provides an opinion on a part of a financial report may or may not be the same actuary. Some jurisdictions may require the separation of these different actuarial responsibilities and/or use the concept of 'peer review', whereby an external actuary reviews the work of an actuary acting for the insurer.[6]

14. Some jurisdictions provide specific responsibilities for the actuary to provide advice to the Board, such as a requirement for the appointment of an "appointed actuary" to protect the interests of policyholders.[7]

15. The auditor referred to in this paper is the external auditor responsible for providing an independent opinion on an insurer's financial statements, and other financial reports where relevant. This paper does not address an audit of the internal control over financial reporting, nor does it discuss an insurer's internal audit function.[8]

16. An external auditor may determine that it is necessary to use the work of an actuary for the purpose of the audit. ISA 620 deals with the auditor's responsibilities regarding the use of an individual or organisation's work in a field of expertise other than accounting or auditing, such as an actuary provides with respect to an insurer, when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.

17. An actuary or external auditor may also be employed or engaged by the insurance supervisor in carrying out supervisory responsibilities or providing an opinion to the supervisor. Their roles and responsibilities serving in this function are outside the scope of this paper.

Roles and responsibilities

18. This section of the paper considers the relevant roles and responsibilities of key participants in financial reporting by insurers.

Board and management

19. Ultimate responsibility for financial reporting usually lies with the Board of Directors ("the Board"), its committees and the management (hereafter referred to collectively as "the Board and management") of the insurer.[9]

20. This would include responsibility to determine whether accounting estimates, such as technical provisions[10], have been recognised, measured and disclosed in the insurer's financial reports in accordance with the applicable financial reporting framework.

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[6] See also the IAIS *Guidance paper on the use of actuaries as part of a supervisory model* (2003).

[7] The appointed actuary is defined in the *IAIS Glossary of Terms* and discussed further in the joint IAIS/OECD *Issues Paper on Corporate Governance*, July 2009.

[8] Except for the reference in paragraph 21 to management's responsibility for the insurer's control environment.

[9] Governance structures are discussed in more detail in the joint IAIS/OECD *Issues Paper on Corporate Governance*, July 2009.

[10] Amounts set aside on the balance sheet to meet liabilities arising out of insurance contracts, including claims provision (whether reported or not), provision for unearned premiums, provision for unexpired risks, life assurance provision and other liabilities related to life insurance contracts (e.g. premium deposits, savings accumulated over the term of with-profit policies). See *IAIS Glossary of Terms*, available at www.iaisweb.org.

21. The Board, its committees and management are also responsible for the governance structure and the control environment in which financial reports are prepared. This may include, inter alia, ensuring that:

- staff, in particular those in key positions, have integrity and appropriate expertise and experience
- adequate accounting procedures are in place and are complied with
- appropriate management information systems are in place and operating effectively
- adequate checks and balances and internal controls are in place and operating effectively
- appropriate risk management and compliance policies and procedures are in place and operating effectively
- an appropriate internal audit function[11] reviews and reports regularly to the Board and management on the performance of internal controls
- the appointment of actuaries and external auditors is subject to fit and proper requirements and the absence of conflicts of interest.

22. The responsibilities of the Board and management are not reduced by a requirement for an insurer's financial reports to be audited, by the use of actuarial expertise in determining the accounting estimates, or by the existence of insurance supervision. Also, when the work of an actuary is used as audit evidence by the external auditor for the purpose of the audit, this does not diminish management's responsibility to ensure that an adequately skilled insurer's actuary is involved in the preparation of the financial reports.

Actuary[12]

23. The application of actuarial expertise contributes significantly to the operation of insurers, insurance markets and supervisory authorities.

24. Actuarial expertise includes skills to assess the risks inherent in assets and liabilities, establish capital adequacy, determine the adequacy of premiums and establish technical provisions for both life and non-life insurance and insurance-related business. These skills may include, inter alia, a thorough understanding of:

- the business of insurance[13] and the nature and evaluation of insurance risks (eg mortality, morbidity, claims frequency and severity)
- the use of statistical techniques, including statistical models
- the use of the time value of money
- the risks inherent in assets and liabilities
- the use of financial instruments including derivatives
- the volatility and the uncertainty associated with accounting estimates·
- governance principles and risk methodologies.

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[11] Small firms which do not have their own internal audit department may outsource this function to a external resource, for example to a firm of auditors other than the audit firm engaged to perform the external audit.

[12] Further information on the role of the actuary is given in the IAIS Guidance Paper *The use of actuaries as part of the supervisory process* (2003).

[13] Including reinsurance and alternative risk transfer.

25. The actuary involved in the financial reporting process would be expected to be objective, not under significant management influence, and with a sufficient understanding of:

- the governance structure and internal control environment of the insurer and any relevant regulatory or other supervisory issues the insurer has had
- the business and risk environment in which the insurer operates, which may have an effect upon the information reported
- the purpose for which the reports are being prepared
- his legal or other rights relevant to the financial reporting process, such as access to the Board and protection for whistle-blowing.

26. Financial reports often include amounts that either are determined by an insurer's actuary or have utilised the expertise of an insurer's actuary in their preparation. The accounting estimates related to, but not limited to, technical provisions have a pervasive and significant effect on the financial reports of insurers.

27. The insurer's actuary may utilise the expertise of the external auditor, such as in the use of data to calculate accounting estimates (including technical provisions) which has been subject to audit procedures. Where this occurs, this does not reduce the responsibility of the insurer's actuary for carrying out his own checks over data quality.

28. In some cases the insurer's actuary may be responsible for providing an opinion to third parties, such as the supervisor, on the appropriateness or sufficiency of amounts contained in financial reports or the methodology or assumptions used for deriving the same.

29. Where there are differences between different sets of reports (ie between general-purpose financial reports and those required for supervisory purposes), actuarial expertise may be required not only in preparing estimates for use in these financial reports, but also in helping to explain the effect of and the differences in the bases of reporting and the accounting estimates.

30. Where the insurer's actuary is responsible for determining amounts for consideration by the Board and management to be included in the financial reports, or in expressing an opinion on amounts contained in financial reports, it would be particularly important that he is free from undue influence in doing so and is able to communicate adequately with the Board and management, the external auditor, insurance supervisor and other relevant party in performing his work. An actuary would need to have free access to all company-related information and personnel which he deems necessary to conduct the actuarial work. The actuary would need continuously to be aware of any potential conflicts of interest, addressing these as necessary with the Board or the insurer's compliance function.

31. In some jurisdictions there may be a requirement that some or all of the work of the actuary be peer reviewed by an independent actuary. Such a requirement may be made by the supervisor or by the professional standards applying to the actuary.

32. Some jurisdictions impose a cooling off period before an insurer's actuary can serve as an auditor's actuary in respect of the same insurer to enhance the independence of both functions.

External auditor

33. The role of the external auditor is to express an independent opinion, based upon the audit work, on an insurer's financial reports taken as a whole, which may include, but is not limited to, general-purpose financial statements, regulatory reports, capital adequacy and other special reports. In performing this role the external auditor brings his accounting and auditing expertise to the financial reporting process, including a sufficient understanding of the applicable financial reporting framework. The external auditor needs to be independent

and have free access to all company information and personnel which he deems necessary to conduct the audit work.[14]

34. In some jurisdictions the external auditor also has responsibilities in respect of reporting on the soundness of the company and the company's governance, risk management, or internal control environments.

35. In addition to the company's Board and audit committee, those who use and rely on an external auditor's report can vary depending on the purpose of the report or audit. They may include the shareholders of the insurer or other stakeholders such as insurance supervisors and policyholders. The auditor's opinion plays a critical role in establishing the credibility of the financial reports.

36. In some jurisdictions the audit opinion and related audit processes are important inputs into the supervisory process, particularly where inputs into regulatory reporting or capital adequacy calculations are based on information from audited financial statements. In some cases the external auditor provides an audit opinion on the regulatory, capital adequacy, or other reports required for supervisory purposes.

37. In some jurisdictions the external auditor is required to report to the insurance supervisor any fact or decision that may:

- constitute a material breach of laws or regulation
- constitute an offence involving fraud or dishonesty
- put at risk the interests of the insured
- affect the insurer's ability to continue as a going concern, or
- lead to a qualified audit opinion.

38. As noted in paragraph 26, due to the nature of the accounting estimates of an insurer (in particular technical provisions), determining such estimates is often a complex process. Both the calculation and audit of such estimates require the use of appropriately qualified experts. In view of this, an auditor may determine it necessary to use the work of an actuary (see also paragraph 16).[15]

39. Where the auditor uses an actuary, referred to in this paper as the "auditor's actuary", within the audit, the auditor nevertheless has sole responsibility for the audit opinion, and that responsibility is not reduced by the use of the work of an actuary.

40. The role of an auditor's actuary will depend largely on the business of the insurer and the circumstances in which the audit is conducted, and may range from extensive involvement in all phases of the audit to a more limited participation in specific areas. The extent and nature of involvement will depend inter alia on the nature of the insurer's major product lines, the adequacy of the insurer's controls and the qualifications of the insurer's actuary.

41. The use of an auditor's actuary, although usually required, may not be necessary in limited circumstances, for example:

- where technical provisions or accounting estimates requiring the use of actuarial skills are not material to the audit
- where technical provisions or other accounting estimates are highly predictable.

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[14] The independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with international auditing standards is dealt with in ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.*

[15] Determining the need for an auditor's expert is discussed in paragraphs A4-A9 of ISA 620.

42. The involvement of an actuary in the audit process helps the external auditor to gather sufficient appropriate audit evidence (see paragraph 43). However, this involvement does not of itself automatically fulfil any existing requirements of the external auditor to obtain sufficient appropriate evidence to support the audit opinion. Key areas in which actuarial involvement in audit procedures may assist the audit include:

- obtaining an understanding of the insurer and its environment, including internal controls, relevant to auditing technical provisions or other accounting estimates
- identifying and assessing the risks of material misstatement of technical provisions, including determining whether any of the assessed risks require special audit consideration or represent risks for which substantive procedures alone do not provide sufficient appropriate audit evidence
- determining an overall assessment of risks of material misstatement at the financial statement level, including in the context of the audit of technical provisions or related amounts
- designing and performing audit procedures with respect to technical provisions, including tests of the operating effectiveness of controls, and substantive procedures whose nature, extent and timing are responsive to the assessed risks of material misstatement
- assessing whether the methodology used in the development of technical provisions is consistent with acceptable standards and guidelines
- testing the assumptions used in, and the robustness of, internal models if these are used to set technical provisions or capital requirements.

43. The auditor's actuary may assist in performing substantive procedures on areas used in determining accounting estimates, including technical provisions, or in expressing an opinion on them. These may include:

- testing of the computations
- testing of the modelling
- testing of the reasonableness of assumptions
- developing independent estimates.

The nature, timing and extent of assistance can be influenced by factors such as the complexity of the technical provisions or underlying risks, the external auditor's cumulative knowledge of the integrity of the technical provisioning process, the effectiveness of the internal control structure, the degree of confidence in the quality of work of the insurer's actuary, [16] the degree and nature of changes in technical provisions in the current year, and other changes in areas that may affect technical provisions.

44. Where the external auditor has concerns over the reliability of the audit evidence obtained (including from his review of the work of the insurer's actuary[16]), ISA 500 requires the auditor to determine what modifications or additions to audit procedures are necessary to resolve the matter and to consider the effect of the matter, if any, on other aspects of the audit.[17]

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[16]The actuary referred to here would be the actuary responsible for the work as well as other actuaries who assist in carrying out the work. It would not necessarily include other actuaries in the external firm who are not involved in carrying out the work or other actuaries employed by the insurer who are not involved in preparing the technical provisions or other actuarially calculated values used in the insurer's financial statement.

[17] See ISA 500 Audit evidence, paragraph 11.

45. The insurer's actuary would not be expected to be permitted to provide actuarial assistance to the external auditor as the auditor's actuary regarding values used in the same financial report, and vice versa, to protect the objectivity of both. Although, it may be preferred that the roles of auditor’s actuary and insurer’s actuary be fully independent, some jurisdictions permit the auditors actuary to act as an insurer’s opining actuary – but not as the insurer’s actuary which supports management in its determination of values included in a financial report – provided that sufficient internal controls are in place. External auditors are subject to independence rules and codes of conduct that may prohibit an external auditor from working simultaneously as the insurer’s actuary.[16]

46. Some jurisdictions impose a cooling off period before a former director or employee of an audited entity, who was in a position to exert significant influence over the preparation of the financial statements, can be assigned to a position within the audit firm in which they can influence the conduct or outcome of the audit.

Supervisor

47. The insurance supervisor requires certain financial reports to help him carry out his supervisory responsibilities in respect of the insurer. The supervisor may require receipt of an insurer’s audited financial statements, and in some jurisdictions be responsible for making them publicly available.

48. The supervisor may require the audit of other financial reports, such as those included as part of regulatory returns and supporting schedules and in some cases financial information about particular transactions or risk exposures. Local laws, regulations and other supervisory reporting requirements may govern the format, content and timing of such reports. The supervisor may also request or require additional recurring or ad-hoc reports, such as management letters (see paragraph 64), as necessary. In many cases the supervisor will require the information to be subject to actuarial review or be audited. These may take the form of a professional opinion or report prepared by the external auditor.

Communication

Between the insurer's actuary and the external auditor

49. Effective communication between the insurer's actuary and the external auditor can be important in ensuring a clear basis upon which the work of the actuary and external auditor can be coordinated. This can help establish an understanding of the scope and approach to be taken in the course of the work by each professional and the nature and extent of reliance that might be placed by each on the work of the other.

50. Before accepting an engagement regarding a financial report of an insurer that requires actuarial expertise regarding a significant element of the financial report, it would be desirable for the external auditor to obtain from the insurer the right to communicate with the insurer's actuary, and receive the information needed in carrying out the audit, and for this understanding to be documented by exchange of letters. If such a right were not granted by management, or if there were no suitable and acceptable indirect method of obtaining this information, it would be expected that the external auditor would not accept the engagement.

51. The insurer's actuary and the external auditor are encouraged to exchange information which may be relevant to each other’s work. Such information may sometimes be useful to one party in obtaining a proper understanding of the work of the other. Sometimes the information may be exchanged indirectly through management.

52. The exchange of information between the two professionals may be subject to law or regulation and to independence requirements of the auditor. It would generally be expected that management would be informed of this exchange of information, unless circumstances

require confidential treatment. It may also be useful or efficient for the supervisor to have access to the exchange of information between the parties.

53. Communication between the insurer's actuary and external auditor would be expected to commence during the planning stage of the audit and actuarial work and continue throughout these processes.

54. When the external auditor intends to place reliance upon the work of the insurer's actuary he would ordinarily:

a. inform the actuary of his intended use of the actuarial work and confirm the reporting standards under which the accounting estimates and financial values to which the actuary provides input will be used

b. inquire as to whether the actuary has been appointed by the appropriate body to perform the work that the external auditor intends to use, as applicable

c. inquire under which professional standards the actuary intends to carry out his work

d. discuss whether the actuary's work can meet the external auditor's needs with respect to information used by or produced by the insurer's actuary. This may include, inter alia, a discussion of:

   - the scope of actuarial work, for example, which accounting estimates will be determined or on which an opinion will be expressed by the insurer's actuary
   - the basis under which accounting estimates are to be determined, eg IFRS or local regulatory standards
   - materiality, to determine what data is material to the actuarial analysis, so that the external auditor can determine whether additional testing should be performed
   - the proper treatment of subsequent events, to determine that the insurer's actuary understands how events arising after the reporting date are to be treated and that the insurer's actuary will consider the effect of matters that come to his attention up to the date of his report
   - identification and verification of data used or relied upon by the insurer's actuary that may be significant to the audit opinion, to ensure that reasonable assurance will be obtained with respect to the accuracy and completeness of the data used by the insurer's actuary in the determination or expression of an opinion regarding a value subject to audit testing
   - the timing of the work to be carried out by the insurer's actuary and the date of his report
   - any questions relating to the insurer's actuary's work.

e. share with the insurer's actuary his findings regarding the reliability of data that the insurer's actuary relies upon.

55. With respect to the items listed in paragraph 54, the insurer's actuary would ordinarily:

a. discuss any issues expected to be encountered in meeting the needs of the external auditor in a timely manner

b. assist the auditor in determining whether there is a basis for using his work

c. provide a copy of the actuarial report or work product, as applicable, relevant to the auditor.

Between the insurer's actuary and the insurance supervisor

56. Insurance supervisors benefit from actuarial work in general. In some jurisdictions, actuaries are legally obliged to report to the supervisor, such as in respect of actuarial reports and their whistle-blowing role. In addition, due to the more complex risk-taking activities of some insurance companies, especially within internationally active insurance groups, actuarial experience and knowledge are relevant to the day-to-day supervision of the insurance industry. Therefore, regardless of legal and regulatory obligations, close communication between actuaries and insurance supervisors is encouraged. The supervisor may also initiate communication with the actuary to clarify matters relating to the work of the actuary and, for that reason, it is desirable that the actuary be accessible to the supervisor.

Between the external auditor and the insurance supervisor

57. Insurance supervisors benefit from the results of the external auditor's work. In addition to the audited general-purpose financial statements, paragraphs 69 to 72 below describe types of communication between the external auditor and the Board and management which are likely to be of interest to insurance supervisors.

58. In addition, and as noted in paragraph 37, in some jurisdictions the external auditor is required to report to the supervisor certain types of significant matters encountered during the course of the audit which may require the supervisor's urgent action (generally where these have not been reported by the Board or management to the supervisor). Such matters might include

- the insurer's failure to comply with a law or regulation
- concerns over its ability to meet solvency requirements
- putting at risk the interests of the insured.

Where there is no such requirement, in some jurisdictions the external auditor would nevertheless be expected to consider communicating such matters to the supervisor when the Board or management is unwilling to do so, subject to applicable legal considerations including whether the law provides protection in the case of such communications.

Reporting

59. Where the amounts determined by the insurer's actuary are significant to a financial report required for supervisory purposes on which the external auditor expresses an opinion, it is desirable that a report of each opinion should be included within the financial report. The report would be expected to describe their respective roles.

<u>Insurer's actuary</u>

60. Where the insurer's actuary prepares a report regarding the preparation or actuarial review of accounting estimates (principally technical provisions) included in a financial report, this report can be expected to include the following:

- identification of the actuary and his qualification to conduct the work
- identification of the scope (nature, extent and purpose) of the work and any specific terms of reference
- identification of the financial report or data to which it relates
- identification of the actuary's relationship to the entity to which the financial report or data relate
- confirmation of awareness that the external auditor intends to consider the actuary's report and the work supporting it in the audit of the financial report

- the actuary's findings and opinion, if applicable, including a representation that the work was performed in accordance with applicable professional standards (see also “Professional standards and qualifications” below).

Some of the above may be covered implicitly through the format or legal status of the report.

61. The actuary would be expected to conduct his work on the basis of standards that apply to actuarial practice and the applicable financial reporting framework.

62. In many jurisdictions local regulations require an actuary’s report on the value or adequacy of technical provisions to be provided to the supervisor. The same requirement may apply to other financial reports. Such reports and the work that forms their basis may also form the basis for reports which the actuary provides to management or to the external auditor.

External auditor

63. The external auditor reports inter alia on the insurer’s financial statements in accordance with applicable auditing standards, applicable laws and regulations, and the applicable financial reporting framework.

64. In connection with the audit of the financial statements the external auditor may be required to report to the management or to those charged with governance (for example, the audit committee) on matters related to governance and internal controls which came to light during the course of the audit. In some jurisdictions such reports may also be required by the supervisor.

65. Reporting by the external auditor to the supervisor or to the Board or management, as applicable, on other financial reports or information, such as regulatory reports or special purpose reports to the supervisor, are governed by the engagement terms for that work and applicable auditing standards.

Relationship between external auditor and insurance supervisor

66. Whilst the role of the actuary within the supervisory process is discussed in other IAIS literature,[18] there is no separate paper that discusses the relationship between the external auditor and the supervisor. As a result, one aim of this paper is to promote an understanding of supervisors’ expectations regarding the role of the external auditor within a supervisory framework. As noted in the introduction to this paper, the IAIS confirms the importance of the role of the external auditor in this context.

67. In many respects insurance supervisors and external auditors face similar challenges and, increasingly, their roles with respect to relevant financial reports are perceived as complementary. Although their focus is different, nonetheless there are many areas where the work of the insurance supervisor and the external auditor can be useful to each other.

68. Insurance supervisors benefit from the results of the external auditor’s work. Effective insurance supervision requires the collection and analysis of reliable information about supervised insurers. This includes various financial reports, some or all of which may require an audit. Where these reports are audited, the supervisor may be able to place greater reliance upon them.

69. As part of the audit the external auditor ordinarily communicates certain information to the Board and management. This information generally includes comments on such matters as material weaknesses in internal control or misstatements in the accounting records which have come to light during the course of the audit.

[18] See in particular the IAIS *Guidance Paper on the use of actuaries as part of a supervisory model* (2003)

70. Communication between the external auditor and the insurer's Board and management and other reports prepared by external auditors can provide supervisors with valuable insight into an insurer's operations.

71. It is desirable for such communication to be made in writing and hence form part of the insurer's records and external auditor's workpapers.

72. In performing the audit the external auditor may encounter matters of relevance to the governance of the insurer. International auditing standards require such matters to be communicated to those charged with governance.[19] These may also be of use to the supervisor. When required by law, regulation or agreement, the external auditor also communicates such matters to the supervisor. Where there are no such requirements the external auditor may wish to encourage the Board or management to do so.

73. The supervisor may sometimes request the insurer's external auditor (or another external auditor) to undertake work that assists in the performance of his supervisory roles, such as auditing a specific area or reporting on compliance with licensing conditions, or on the adequacy of the internal control systems.

74. In some jurisdictions the insurance supervisor has statutory powers over the appointment of the external auditor of an insurer, such as the right of approval or removal. These powers are intended to ensure that management appoints an external auditor who has the necessary capabilities and competence to perform the audit engagement in accordance with professional standards and regulatory and legal requirements. Supervisors may also request reasons for changes in external auditor and, if necessary, investigate circumstances that caused an external auditor not to be reappointed. In some jurisdictions the supervisor may simply need to be informed of the appointment or removal of the external auditor.

75. There may be situations where information available to a supervisor about an insurer would assist the external auditor in his work. The supervisor would decide on a voluntary basis what information, and in what form, to provide to the external auditor, unless otherwise required by law.

76. The supervisor may also initiate communication with the external auditor to clarify matters relating to the work of the external auditor and, as a result, it is desirable that the external auditor be accessible to the supervisor.

Professional standards and qualifications

77. In accordance with ICP 7, insurance supervisors should require external auditors and insurers' actuaries to be fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competence, experience and qualifications.

78. The advanced criteria "h" and "i" of ICP 7 respectively state:

- "Criteria to assess the fitness and propriety of auditors and actuaries include qualifications, professional proficiency, appropriate practical experience and updated knowledge on developments within their profession and membership of professional bodies.
- In the case of auditors and actuaries, the supervisory authority may give regard to or rely on professional bodies that set and enforce standards of professional conduct."

[19] See ISA 260 *Communication with those charged with governance* which provides guidance to auditors on this subject.

Supervisors therefore need to consider the following in relation to external auditors and actuaries, in respect of both the individuals and firms concerned,[20] as appropriate:

- Professional qualifications
- Membership of professional bodies
- Continuing professional development
- Compliance with professional standards and guidance
- Professional discipline.

Professional qualifications

79. Professional qualifications underpin the quality of the work carried out by professionals and in which the supervisor has an interest. Supervisors would be expected to consider whether the insurer's actuary and the external auditor have appropriate professional qualifications and experience.[21]

<u>Actuary</u>

80. Unlike the external auditor, the insurer's actuary may be an individual employed by the insurer itself or may be employed by an independent firm or be self-employed.

81. Actuarial qualifications can be obtained through different routes that can differ by jurisdiction. In some jurisdictions, for example the UK and US, qualification is obtained through examinations set by an appropriate professional actuarial body. In other countries, such as France, qualification is obtained through the completion of a required set of university courses and examinations set by one of several universities leading to the award of a diploma. Although in many jurisdictions the local actuarial body sets its own syllabus and examinations, some jurisdictions rely on qualifications issued by one or more of the larger actuarial bodies such as the (US-based) Society of Actuaries, the (US-based) Casualty Actuarial Society or the (UK-based) Institute of Actuaries. In other countries, qualification is provided through a government agency, such as in Finland where the Ministry of Social Affairs and Health arranges examinations and grants qualification. Membership qualification often also includes a minimum requirement of practical experience.

82. To be an actuary who carries out a specific regulatory role, such as being the appointed actuary to a life insurer, may in certain jurisdictions require an additional practicing certificate or other requirement such as a given number of years of relevant experience specific to that role.

<u>External auditor</u>

83. The external audit function is carried out by audit firms or individual auditors, with the work signed off by a partner[22] who is professionally qualified and has a minimum number of years of relevant experience.

84. In some jurisdictions the audit partner can only serve in that capacity for a maximum number of years, for example five. A comparable requirement for an insurer's actuary is less common.

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[20] The external audit firm and, if the insurer outsources the actuarial function, the actuarial consultancy firm(s) concerned.

[21] Currently, not all jurisdictions have such a requirement.

[22] The exact designation of the senior audit personnel authorised to sign off the audit report of a set of financial statements may vary between jurisdictions (for instance in some jurisdictions a director or manager may be a signatory).

85. There are both locally and internationally obtainable accounting qualifications. The ACA qualification, for example, is unique to the Institute of Chartered Accountants in England and Wales, while the ACCA qualification is granted by the Association of Chartered Certified Accountants, a worldwide body which has links with individual professional bodies in a number of countries. In the US, the CPA qualification is obtained by passing the Uniform CPA examination maintained by the American Institute of Certified Public Accountants.

Membership of professional bodies

86. Supervisors would be expected to confirm that the insurer's actuary responsible for providing either the accounting estimates or financial values or an opinion thereon and individual external auditors who have signing powers with respect to audits are members of recognised professional bodies. In certain jurisdictions in which there is no applicable recognised professional body, supervisors would be expected to ensure that adequate qualifications are held.

<u>Actuary</u>

87. Most jurisdictions have their own professional actuarial body, although some smaller jurisdictions may not. Actuaries working in one jurisdiction may be members of another professional actuarial body in another jurisdiction. Most of these professional bodies are full members or associate members of the International Actuarial Association (IAA). Associations are only admitted as full members if they meet certain minimum criteria, including having a code of professional conduct, a disciplinary procedure and a minimum set of educational requirements for their members.

<u>External auditor</u>

88. Most jurisdictions have their own professional accountancy bodies, although accountants working in one jurisdiction may be members of a body in another jurisdiction, and some smaller jurisdictions may not have their own professional body. The International Federation of Accountants (IFAC) is the global organisation for the accountancy profession. Membership of IFAC is subject to meeting specified criteria and members and associates are required to participate in IFAC's Member Body Compliance Program to demonstrate that they are maintaining good standing and addressing the requirements of membership.

Continuing professional development

89. It is important that both individual actuaries and external auditors keep their professional knowledge up to date. For members of certain professional bodies, there is a compulsory requirement to spend a specified minimum number of hours per year or longer period on continuing professional development (CPD).

Compliance with professional standards and guidance

90. Supervisors may wish to obtain confirmation that actuaries and external auditors who are responsible for the preparation of insurers' financial reports or provide professional opinions regarding such financial reports comply with relevant professional standards and guidance. This confirmation could be satisfied by requiring a specific statement to that effect to be included in audit reports or actuarial reports.

<u>Actuary</u>

91. Actuarial standards and guidance are generally set by individual actuarial associations or by other standard-setting bodies at the national level. Examples are Professional Standards and Guidance Notes issued by the Institute of Actuaries of Australia, Actuarial Standards of Practice issued by the US Actuarial Standards Board and by the Actuarial Standards Board of the Canadian Institute of Actuaries, and Actuarial Standards issued by the UK Board for Actuarial Standards. The International Actuarial Association is also developing a set of International Actuarial Standards of Practice and International Actuarial

Notes for use with respect to international financial reporting standards. Some of these standards and guidance specifically cover the role of actuaries in relation to audit work and the interaction with the external auditor.

External auditor

92. The accounting profession develops and promotes professional standards, in particular, auditing, assurance and public and private sector financial reporting standards, as well as ethical standards and education standards. The International Auditing and Assurance Standards Board (IAASB), established by the International Federation of Accountants (IFAC), sets International Standards on Auditing (ISA). In addition, certain countries have their own auditing standards, such as those promulgated by the Public Company Accounting Oversight Board in the US for audits of certain listed companies. External auditors who are members of IFAC have to comply with IFAC's Code of Ethics for Professional Accountants as well as relevant national ethical standards. In excess of 100 countries are now using or in the process of adopting ISAs into their national auditing standards. An increasing number of national regulatory bodies are accepting financial statements audited using ISAs.

93. The International Financial Reporting Standards (IFRS)[23] are set by the International Accounting Standards Board (IASB). Although there is a trend towards a universal adoption of IFRS, many individual jurisdictions, which allow or permit reporting under IFRS for listed or public interest companies, retain their own accounting standards for other entities.[24] Some jurisdictions do not yet require or permit reporting under IFRS and rely on local standards. Whilst it is the insurance entities to which the relevant financial reporting standards apply, the external auditor's report on the general-purpose financial statements includes an opinion on their compliance with the applicable financial reporting standards.

Professional discipline[25]

94. Supervisors may wish to confirm that, where there is reliance on the membership of a professional body by actuaries and external auditors, the professional body has an effective disciplinary scheme in force that enables appropriate action to be taken against members that do not follow rules or guidance set by the body.

95. The existence of an effective professional disciplinary process is a prerequisite for an accountancy body to have full membership of the IFAC and a national actuarial association achieving full membership of the IAA.

96. Supervisors may nevertheless decide not to depend on such professional processes entirely and to retain the right to deal with issues of fitness and propriety expeditiously even if some sanctions are carried out through professional association referrals.

Regulation

97. In some jurisdictions the work of the external auditor is subject to public supervision by national audit regulators. There has been significant progress in developments of the public supervision of external auditors across many jurisdictions, as evidenced by the establishment of the International Forum of Independent Audit Regulators.[26]

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[23] Including the International Accounting Standards (IASs) set by the IASB's predecessor body, the International Accounting Standards Committee.

[24] An example is the UK, where local accounting standards are set by the Accounting Standards Board (ASB).

[25] Consideration of cross-border disciplinary powers is outside the scope of this paper.

[26] The International Forum of Independent Audit Regulators was established in September 2006 and at the date of publication of this paper had members which are independent audit oversight authorities from some 30 countries.