

GN7(ROI):THE ROLE OF ACTUARIES IN RELATION TO FINANCIAL STATEMENTS OF INSURERS AND INSURANCE GROUPS WRITING LONG-TERM BUSINESS AND THEIR RELATIONSHIP WITH AUDITORS

Classification

Recommended Practice

Legislation or Authority

Insurance Acts 1909 to 1990, Regulations made under those Acts and Regulations implementing European Union Directives relating to insurance business made under the European Communities Act 1972 (“Insurance Acts and Regulations”)

Companies Acts 1963 to 1990 and Regulations made under those Acts (“Companies Acts”)

European Communities (Insurance Undertakings: Accounts) Regulations 1996 (“1996 Regulations”)

Auditing Guideline 311A (Life Insurers in the Republic of Ireland) issued by the Councils of the Accountancy Bodies (and effectively adopted by the Auditing Practice Board) (“Auditing Guideline 311A”)

Auditing Practices Board Bulletin 1998/2 – Using the Work of an Actuary with regard to Insurance Technical Provisions (“APB Bulletin 1998/2”)

European Communities (Life Assurance) Framework Regulations 1994 (“Supervisory Returns”)

Application

This Guidance Note has been issued to give advice to:

- Actuaries calculating the long-term business provision for inclusion in the financial statements of a Republic of Ireland authorised insurance company or a Republic of Ireland domiciled insurance group;
- Appointed Actuaries;
- Other actuaries involved in the preparation of financial statements under the Companies Acts for companies or groups transacting long-term insurance business and domiciled in the Republic of Ireland; and includes, in particular, advice regarding their relationship with the Auditor of those statements and the Supervisory Returns.

Version Effective from

1.0 25.04.1995

2.0 06.01.1999

1. Introduction

- 1.1 The Companies Acts, together with the 1996 Regulations, require that technical provisions for long-term insurance business be shown explicitly in the annual financial statements and hence they fall within the scope of the audit. This is a significantly different situation from that relating to the Supervisory Returns where the Auditor, when giving an opinion, is permitted to have reliance on the certificate given by the Appointed Actuary.
- 1.2 This Guidance Note explains the professional duties of the various parties in relation to the financial statements under the 1996 Regulations and the relationships between them. It also refers to the relationship between the Appointed Actuary and the auditors in the preparation of the Supervisory Returns.
- 1.3 The 1996 Regulations have introduced a new professional role for the actuary. The actuary fulfilling this role is referred to in this Guidance Note as the Reporting Actuary. The introduction of this new role in no way diminishes that of the Appointed Actuary, whose duties remain central to maintaining the soundness of the long-term business of insurance companies.
- 1.4 The 1996 Regulations require an insurance company writing long-term insurance business to have a Reporting Actuary. In the case of an insurance holding company, however, it may be possible for the company to consolidate the results of its subsidiaries without the involvement of a Reporting Actuary to the holding company and hence for holding companies the role of Reporting Actuary may not exist. Any actuary who is in any doubt about whether or not he or she is fulfilling the role of a Reporting Actuary should seek clarification of his or her status from the company's directors.
- 1.5 This Guidance Note does not apply to a pension scheme actuary notwithstanding that calculations performed by such an actuary may have implications for the company's financial statements.

2. The Directors

- 2.1 The directors of an insurer writing long-term insurance business or of an insurance holding company are responsible for all statements made and amounts shown in financial statements prepared under the Companies Acts. To the extent that these statements contain amounts calculated by an actuary, the directors will be placing reliance on the professional expertise of the actuary to calculate the amounts. Nonetheless the directors remain legally responsible for the preparation of the financial statements and ensuring that they give a true and fair view of the state of affairs, and results, of the company.
- 2.2 As explained in 3.2 below, it is perfectly proper for the directors to give instructions to the Reporting Actuary on the general approach to be adopted in carrying out his or her work. This contrasts with the situation applicable to the Appointed Actuary's equivalent calculations for the Supervisory Returns.

3. The Reporting Actuary

- 3.1 The 1996 Regulations state that for the long-term business provision, in the case of an insurance company, the "computation shall be made on the basis of recognised actuarial methods annually by a Fellow Member of the Society of Actuaries in Ireland, with due regard to the actuarial principles laid down in Council Directive 92/96/EEC". The "making of the computation" requires the exercise of professional judgement and hence an individual actuary must provide that judgement. This actuary is referred to as the Reporting Actuary in this Note.

- 3.2 The Reporting Actuary's principals are the directors of the organisation to whom he or she reports, and as mentioned in 2.2 above it is perfectly proper for the directors to give the Reporting Actuary instructions regarding the broad approach to be followed in the calculation of the long-term business provision. However, the Reporting Actuary should be aware that readers of the financial statements will be placing reliance on the figure shown and in this regard the requirements of the Memorandum of Professional Conduct as regards duties to third parties are relevant.
- 3.3 In many instances, the Reporting Actuary will be the same person as the Appointed Actuary, but this need not necessarily be the case. Also, in the preparation of holding company accounts, there is no Appointed Actuary to the holding company and a number of individuals may hold the position of Appointed Actuary to various subsidiaries.
- 3.4 The Reporting Actuary needs to be familiar with accounting principles and current auditing practice as well as the relevant regulations. This is because the computations are being made within a Companies Acts framework where a different methodology may be applicable to that appropriate for a solvency test. Moreover, the application of the accounting principles in SSAP 2 must be interpreted in accordance with the particular circumstances applying in any given situation. It is recommended that, prior to carrying out the calculations, the Reporting Actuary ensures that the Auditor is aware of the approach which it is proposed to adopt in any situation where there is particular uncertainty regarding the application of these principles.
- 3.5 The Reporting Actuary may choose to base the calculation of the long-term business provision on the equivalent mathematical reserves calculated by the Appointed Actuary but where this is the case the Reporting Actuary retains full responsibility for the calculation of the long-term business provision. In calculating the long-term business provision for inclusion in the financial statements, the Reporting Actuary may decide to modify the reserves calculated by the Appointed Actuary to reflect the fact that the financial statements are being prepared within a Companies Acts framework, for example by reducing the level of provision established for contingencies. Modifications may also be necessary if assets are valued on a different basis, for example by using an amortised cost basis for fixed interest securities, and to reflect any explicit asset representing deferred acquisition costs (and associated deferred tax) if the Appointed Actuary has allowed for these in the mathematical reserves.
- 3.6 The Reporting Actuary may reach different professional judgements from the Appointed Actuary but should defer to the Appointed Actuary on matters regarding policyholders' reasonable expectations. For example, if the Reporting Actuary's advice is sought as to the relative amounts of the long-term business provision, the fund for future appropriations and the reserves for shareholders, the Reporting Actuary should consult with the Appointed Actuary to ensure that policyholders' reasonable expectations are appropriately recognised.
- 3.7 Where it is proposed that the long-term business provision of an overseas subsidiary be consolidated using local GAAP or statutory reserves, the Reporting Actuary should ensure that the accounting policies used to determine such provisions are not materially different from those of the group financial statements. The Reporting Actuary will have to consider the relationship between the long-term business provision and the deferred acquisition cost asset, together with the approach taken to deferred taxation, in forming this judgement.
- 3.8 It is possible that more than one Reporting Actuary will be required to provide results for an insurer because of the need to report at both company and group level. This could lead to different methods and assumptions being adopted. In these circumstances, the Reporting Actuaries should liaise to ensure that data and realistic assumptions agree, even if the profiles of the different companies require different figures to be included in the calculations, for example owing to a differing approach being taken to margins.

- 3.9 There are aspects of work where the Reporting Actuary may be relying on other areas within the company to produce information on which to base his or her calculation of the long-term business provision. This information will be subject to audit but it may be inappropriate for the Reporting Actuary to place reliance on the Auditor for its accuracy or completeness as the Auditor may have carried out the work to a different level of materiality from that required by the Reporting Actuary. Further, the Auditor may well take the view that it is inappropriate to extend the scope of the Auditor's work to give comfort to the Reporting Actuary. This is on the grounds that the work of the Reporting Actuary may be regarded as being central to the preparation of the financial statements in which case the Auditor is required to be able to express an independent opinion on it.
- 3.10 The statutory role of the Reporting Actuary is restricted to the calculation of the long-term business provision. It is also likely that actuarial advice will be needed to calculate other elements of the balance sheet and profit and loss account. Examples of where this is likely include the derivation of the technical provisions for linked liabilities and the determination of the deferred acquisition cost asset and its pace of amortisation. Any actuary advising on these other aspects of the financial statements needs to be aware of the accounting policies adopted throughout the accounts and to ensure that advice given is consistent with them. Experience shows that particular care is needed in the area of deferred taxation, where any test of the recoverability of a deferred acquisition cost asset needs to have regard to the size of any corresponding deferred tax liability.
- 3.11 When preparing financial statements a company may be required, or wish, to include an item in its balance sheet representing the present value of part or the whole of its in force business. An actuary may be asked to provide guidance on the calculation of the appropriate amount, and the pace of any future amortisation. As in Paragraph 3.10, the Reporting Actuary needs to be aware of the relevant accounting policies and the requirement for advice to be consistent with these. Similar obligations rest with any actuary asked to provide guidance on reporting under embedded value or similar methods of reporting.
- 3.12 An important part of the Reporting Actuary's work is the preparation of a report to the directors setting out the approach taken to computing the long-term business provision and the material assumptions utilised. Where the calculation of the long-term business provision is based on the equivalent mathematical reserves calculated by the Appointed Actuary, it may be appropriate to describe only those assumptions which differ from those used to calculate the relevant entries in the Supervisory Returns where the directors have received a report from the Appointed Actuary on these latter assumptions. Where the long-term business provision is calculated independently of the mathematical reserves to be established in the Supervisory Returns, a report detailing both the method and assumptions is appropriate.
- 3.13 The Reporting Actuary's report should not only address the amounts computed but also recommend suitable disclosure as required by paragraph 26(3) of Part II of the Schedule of the 1996 Regulations.

4. The Appointed Actuary

- 4.1 The direct role of the Appointed Actuary is restricted to the Supervisory Returns rather than the financial statements prepared under the Companies Acts. The accountancy bodies recognise that the valuation and certification of the liabilities under long-term business for the purposes of the Insurance Acts and Regulations are solely the professional responsibility of the Appointed Actuary. Hence the Appointed Actuary's certificate and Schedule 4 of the Supervisory Returns are not subject to audit.
- 4.2 The directors need to confirm to the Supervisory Authority that, for the purpose of the preparation of the Supervisory Returns, proper accounts and records have been maintained and an appropriate

system of control has been established and maintained, and their opinion on this is subject to audit. Although ensuring compliance with this requirement is not within the statutory duties of the Appointed Actuary, the Actuary is inevitably closely involved with many aspects of this requirement. The Appointed Actuary should therefore be prepared to provide to the directors any relevant evidence concerning compliance (or lack of compliance) with this requirement and to discuss this with the Auditor.

- 4.3 There are areas where the work of the Appointed Actuary and the Auditor overlap, most particularly in checking the accuracy of the policy data and the valuation of the assets. It is inappropriate for the Appointed Actuary to place reliance on the work of the Auditor in these areas unless the Auditor has carried out work in accordance with a specifically scoped assignment outlined in a formal engagement letter. This is because, in most instances, the work of the Auditor will be designed to gain comfort at a different level of materiality from that required by the Appointed Actuary. It should be noted that the situation regarding the ability of the Auditor to carry out additional work for the Appointed Actuary is somewhat different from the position described in paragraph 3.9 above, as the Auditor does not express an opinion on the work of the Appointed Actuary.
- 4.4 For the purpose of the financial statements, the Auditor must form a view as to the ongoing financial progress of the organisation and may wish to discuss with the Appointed Actuary the relevant areas for which the Appointed Actuary is responsible. In particular, the Auditor may wish to see any Financial Condition Report which has been produced, in order to understand the Appointed Actuary's view of the future development of the organisation's finances and the various risks to which the long-term fund is exposed. The Appointed Actuary should be prepared to discuss the issues referred to in the Financial Condition Report with the Auditor but this is not to imply that the Financial Condition Report is itself subject to audit.
- 4.5 The shareholders' capital and reserves shown in the balance sheet of financial statements prepared under the Companies Acts will include an amount which is required not to be treated as realised profits under section 48 of the Companies (Amendment) Act 1983. This amount will include items which will remain within the long-term fund of the company after the payment of the current year's transfer to shareholders. Decisions taken by the Appointed Actuary directly affect this amount and hence the Auditor may wish to discuss issues relevant to it with the Appointed Actuary.

5. The Auditor and the Actuaries advising the Auditor

- 5.1 All companies are required by the Companies Acts to appoint an Auditor whose responsibility it is to form an independent opinion on the financial statements. Specifically, the Auditor gives an opinion as to whether the financial statements as a whole give a true and fair view, that is that they are consistent with generally accepted accounting principles and show a true and fair view of the state of the company's affairs and of the results for the accounting period.
- 5.2 In order to form this opinion, the Auditor needs to obtain sufficient, appropriate audit evidence on all material items in the financial statements. The amount of the long-term business provision calculated by the Reporting Actuary will be one such item. Other material items include deferred acquisition costs, technical provisions for linked liabilities, premiums, claims and taxation. The Auditor does not consider any one item as intrinsically more important than any other.
- 5.3 Auditing guidelines provide help on how auditing standards should be applied to specific industry sectors, and Auditing Guideline 311A deals with long-term insurance. The guidance contained in Auditing Guideline 311A has been supplemented by guidance contained in APB Bulletin 1998/2. It is recommended that actuaries involved in the preparation of published financial statements should be familiar with Auditing Guideline 311A and with APB Bulletin 1998/2.

- 5.4 Guidance on the degree to which the Auditor may place reliance on an “expert” in reaching an opinion is given in Statement of Auditing Standards (SAS) 520 - Using the Work of an Expert. An expert may be employed by the insurance company, be an independent consultant or be employed by the Auditor. It is recommended that actuaries involved in the preparation of published financial statements should be familiar with SAS 520.
- 5.5 In order to form an opinion as required by the legislation, the Auditor has to assess, understand and where appropriate challenge the assumptions underlying the work undertaken by the Reporting Actuary. In supporting a reasonable challenge to the work of the Reporting Actuary, an actuary advising the Auditor will not be in breach of the Memorandum on Professional Conduct.