

**Monitoring Compliance
with Professional Guidance
A Discussion Paper
prepared by the
Compliance/Peer Review Working Party of the
Professional Affairs Board**

1 Introduction

The Working Party was set up by the Professional Affairs Board to examine systems for the monitoring of compliance in professional matters. Following consideration of a report of the Working Party submitted to the Professional Affairs Board and the Faculty and Institute Management Committee, it was agreed that a discussion paper be prepared to enable a discussion in the wider profession to take place on these matters. This paper considers the monitoring of compliance with the professional conduct standard, guidance notes that are practice standards and certain recommended practice guidance notes. It covers compliance generally, but in particular by the holders of Practising Certificates. It does not consider wider quality issues concerning actuarial advice. However, application of many of the procedures outlined to non-monitored activities would enhance the standing of all actuarial work. In the same way, some of the work covered by the forms in the Appendix goes beyond that required to demonstrate compliance with Practice Standards, but should result in an overall improvement in the quality of actuarial work.

1.1 Objective and Terms of Reference (as determined by the Professional Affairs Board and approved by the Faculty and Institute Management Committee)

Objective : To consider how the profession can be satisfied that its mandatory Guidance Notes are being adhered to by members.

Terms of Reference

- 1.1.1 To review the present working arrangements and identify any problems.
- 1.1.2 To consider alternative compliance/peer review processes.
- 1.1.3 To liaise with the Guidance Committees of the Practice Boards (to include the Regulation and Supervision Committees of the Life Board) who will be represented on the Working Party.

1.2 Membership of the Working Party

David Martin (Chairman),
John Bannon.
Wendy Beaver (Pensions Board)
Roy Brimblecombe
Paul Grace
Michael Green (Life Board)
William Hewitson (General Insurance Board)

2 What are the benefits of doing this?

Benefits were identified for employers, clients of actuaries, policyholders, pension scheme members – in fact all ‘stakeholders’ in products or services with which actuaries are associated. Benefits also flow to the actuaries themselves and the profession as a whole.

The following benefits were identified:-

- 2.1** It will strengthen the position of the profession and individual members and will build upon procedures and good practices already adopted by many firms and life offices. For the avoidance of doubt the term “firms” wherever it appears in this paper shall be deemed to include limited liability companies, and groups of companies. The definition is intended to be flexible.
- 2.2** If properly done and appropriately publicised, it will maintain and strengthen confidence in actuaries among the public and users of their services. These would include policyholders and pension scheme members. Clients would be reassured. These effects would lead employers of actuaries to find that the increasing requirement by the public for demonstration of standards to be met, and the cachet of professionalism among actuaries will be seen to give a business advantage. An example might be among firms whose reputation may have been affected during the publicity regarding pensions mis-selling.
- 2.3** The advent of the new Financial Services and Markets Bill presents an opportune moment to introduce these measures voluntarily. The Government and the Financial Services Authority (FSA) may force regulation on the profession if they are not seen to be proactively monitoring compliance.
- 2.4** There is ongoing debate with the FSA towards extending the remit of actuaries (e.g. the role of the actuary in general insurance). If we are seen to have an effective compliance review processes in place, then we can argue more persuasively for the FSA to implement change.

- 2.5** Increasingly Guidance Notes are evolving as an extension to legislation and there is therefore an increasing need for compliance to be policed.
- 2.6** With the increasing impact of 'public interest' awareness there is pressure from consumer associations and the public for all professions to be more accountable.
- 2.6.1 Recent developments in the medical profession include the proposal for compulsory assessment of doctors on a regular basis. That profession is currently committed to this process, and is examining ways to implement it. The public interest awareness issues mentioned above are underlined.
- 2.6.2 Recent developments in the accountancy profession on the regulation required of accountants emphasise the continued development and formalisation of standards in professions. They may be required now to have a predominance of non-accountants on the relevant ethics committee.
- 2.7** The Working Party believe that monitoring of compliance will, in due course, have an effect on the nature of guidance itself, and lead to more regular reviews of the guidance.

3 What should we Monitor?

The terms of reference suggested that adherence to mandatory Guidance Notes should be monitored. The Working Party discussed this and suggested that monitoring should be of adherence to:-

- The Professional Conduct Standards (PCS)
- Mandatory Guidance Notes (i.e. Practice Standards), and
- Certain selected advisory (Recommended Practice) Guidance Notes, as advised to members of the profession from time to time.

It was felt that if the scope of the monitoring was limited to the above, this would allow the introduction of these arrangements to be introduced in a controlled, limited and manageable fashion.

The Working Party believe that the purpose of their proposals is only to monitor adherence to guidance, and not to go substantially beyond this in commenting on the quality of advice.

4. What do others do?

The Working Party found relevant experience in the profession only in North America. Experience of other UK professions was also sought.

4.1 The experience of Canada

The Canadian Institute of Actuaries (CIA) set up a task force in June 1997. This followed an earlier task force on compliance review which had reported early in 1996. The second task force published a report in June 1998. This proposed a review system. Tier 1 was an annual questionnaire for all practice areas, and tier 2, the review of practices named the 'Practice Review' by actuaries independent of the firm. The report and the sample questionnaires were examined by our working party, and the Canadian experience provided substantial information and material for discussion.

A comprehensive summary of the proposals, and the reaction to them is given in an article by Robert J McKay, in the January 1999 edition of the *Actuary* (the newsletter of the Society of Actuaries). This is reproduced as Appendix A1 to this paper.

As a consequence of the strength of opposition voiced by the membership, the task force has now been given a revised mandate to explore alternatives to practice review that would give a greater emphasis to education. The task force is no longer under any obligation to implement the practice review recommendations.

While the task force has reached no conclusions it is now studying peer review, mandatory for public opinions (after a suitable transition period) and voluntary for all other work with the CIA issuing guidelines for peer review.

In a recent article by Paul F Della Penna in the May 1999 issue of the CIA bulletin, (see Appendix A2 to this paper) he distinguishes peer review from practice review as follows “the key distinction is that practice review is an official CIA act. It is always post release and deliberately so. Its subject is the practice of a member or a group of members. On the other hand, peer review is something that members arrange themselves. It is commonly pre-released and addresses a specific report or opinion.”

It is clear that the CIA considered adopting practice review only for life actuaries as they were generally supportive. However, again quoting from the article by Paul F Della Penna “it is okay to define a certain type of work (eg public opinions), but it makes no sense to single out life actuaries, in-house actuaries, male actuaries, or any other subset.”

The task force supports the recommendation that the existing compliance questionnaires be enhanced and changed to diminish the emphasis on compliance and should focus instead on the handling of specific issues of importance so that all members can have a better perception of the range of practice. The compliance questionnaires are also seen as helpful to the practice committees gathering information on the application of standards as input to the process of standards' development.

The situation in Canada is still subject to change and the latest proposals on peer review are now being shared with the membership.

4.2 The experience of the USA

The Society of Actuaries confirmed to the Working Party that it had no formal process for monitoring adherence to professional requirements, relying on self-regulation, publicising the Code of Professional Conduct, and a discipline process. In the US the Actuarial Board for Counselling and Discipline (ABCD) investigates complaints regarding members of the US-based Actuarial organisations, and provides counselling or recommends disciplinary action by the appropriate organisations. A key element related to professional practice requirements in the US is the Actuarial Standards Board, which issues Actuarial Standards of Practice (ASOP). Again, adherence to ASOPs is generally based on self-regulation, publicising of the ASOPs and the discipline process.

4.3 UK Accountancy Profession

While the UK Accounting Profession and Legal Profession regulate firms and not individuals, it was considered useful to find out what they were doing on Compliance Review.

Information about how the accountancy profession monitors compliance with professional standards was obtained from meetings with representatives of UK200, the Institute of Chartered Accountants in Scotland (ICAS) and the Joint Monitoring Unit (JMU).

4.3.1 UK 200

This is a group of 170 out of 10,000 to 12,000 small accountancy firms. They have a small organisation which reviews professional standards of their members. When the various accountancy institutes combined to set up a Joint Monitoring Unit (JMU) for all accountancy firms, they took advice from UK200.

Information obtained at the meeting about monitoring the accountancy profession by UK200 is set out in Appendix B.

It is clear that there are marked differences in the tasks of monitoring the accountancy and actuarial professions (e.g. monitoring firms – many of them very small, as opposed to individuals in firms, as well as different costs for monitoring). However, the similarities to the solutions are worth study – eg annual questionnaires, monitoring internal to the firms, and external monitors. The copies of accountancy monitoring checklists obtained may also prove helpful.

4.3.2 JMU and ICAS

A meeting was held with the JMU on 5 May 1999. The JMU is a limited company owned 80% by the Institute of Chartered Accountants of England and Wales (ICAEW) and 10% each by the Institute of Chartered Accountants of Scotland (ICAS) and the Institute of Chartered Accountants in Ireland (ICAI).

It was set up in 1987 to monitor the compliance of firms authorised to conduct investment business under the Financial Services Act 1986. In 1991, this role was extended to include monitoring the work of registered Auditors, under the Companies Act 1989.

The JMU also carries out investment business monitoring visits under the Financial Services Act on behalf of the Institute of Actuaries. Information obtained at the meeting about monitoring the accountancy profession by the JMU is set out in Appendix C.

4.4 UK Legal Profession

4.4.1 The Law Society of Scotland

The Society pro-actively monitors compliance with the Solicitors Accounts rules and has also issued a booklet for members on Risk Management.

4.4.2 The Law Society of England and Wales

The Law Society introduced, in Spring 1998, Lexcel. Lexcel is a new quality mark which will be awarded by the Law Society to Practices and Legal Departments that are independently assessed as having achieved the Law Society's Practice Management Standard. No compulsion is involved, it is a matter for the individual practice whether to undergo assessment. Details are in Appendix D.

5 How do we currently do it?

5.1 Monitoring of complaints

Complaints received about members are monitored by the Compliance Committee of the Professional Affairs Board. These would include complaints from clients, members of the public, reports from other actuaries and referrals from other regulatory bodies. The complaints can be passed to the disciplinary process, but where this is not appropriate, there is no subsequent monitoring of the individual thereafter. Details of the complaint may, however, be passed to the Secretary of the Practising Certificates Committee and is then taken into account by the Committee when determining whether or not to issue a Certificate. There are some complaints of such a serious

nature that they are referred directly to a disciplinary tribunal without being seen by the Compliance Committee. However, there are also some complaints dealt with in a conciliatory way by the Compliance Committee, to the satisfaction of the complainer, which never reach the length of a disciplinary tribunal.

5.2 Career Progression following disciplinary action

Where individuals are subject to discipline, there are no formal procedures in place although a watchful eye is kept over their subsequent careers. It is suggested however that a more formal procedure be put in place.

5.3 Self Disclosure

Written actuarial advice to a client must state clearly any methodologies adopted and material assumptions made by the actuary. Therefore if an actuary does not adhere to a Guidance Note, he is under an obligation to report to his client why he has not complied and to justify it. In essence this is a form of self-monitoring and the working party considered whether this could be extended to a requirement that such non-compliance could be reported to the profession at the same time as reported to the client. However, reporting to the senior actuary of the relevant firm might be appropriate, as considered later in this paper.

5.4 Monitoring of Appointed Actuaries

5.4.1 Role of the Government Actuary's Department (GAD)

GAD examine each year on behalf of FSA, the financial returns for all life insurers authorised in the UK. This examination includes consideration of whether the valuation methodology and assumptions are consistent with regulations and professional guidance. They are also able to monitor in broad terms other internal reports that may be received from an Appointed Actuary or presented to them during a visit to the life office. In the event of any possible non-compliance being found, then action taken would range from a written warning from GAD to a formal complaint being made to the profession's Investigation Committee.

5.4.2 Audit Firms

The role of the actuaries working for the external auditors of Life Offices does not extend to monitoring the work of the Appointed Actuary in his role in the production of the Supervisory Returns. As stated in 4.1 of GN7, *"the accountancy bodies recognise that the valuation and certification of the liabilities under long-term business for the purposes of the Insurance Act 1982 is 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."*

Indeed, GN7 goes on to state that although the auditors (and actuaries working for them) may need to speak with the Appointed Actuary to form a view as to

the ongoing status of the office as part of their review of the Financial Statements, they cannot imply from this that any evidence obtained from the Appointed Actuary (such as Financial Condition Reports) is subject to audit (GN7, 4.4).

However, with regard to the production of the long-term business provision for the Companies Act accounts, the Reporting Actuary (as separately defined in GN7) is open to challenge from the auditors (GN7, 5.5). As stated in GN7, 3.3 the Reporting Actuary may be the same person as the Appointed Actuary, but this may not necessarily be the case.

The scope of the work of actuaries employed or retained by the auditor is a matter to be agreed between them and the auditor. They would normally be required to consider:

- i) the integrity of the data used;
- ii) the appropriateness of the investigations underpinning the assumptions adopted;
- iii) the controls over the calculations including the documentation and testing of any relevant computer programs;
- iv) the controls over the consolidation of the results; and
- v) the completeness of any analysis of change as it relates to business activities.

The actuaries' assistance to the auditor would normally extend to seeking to understand any trends within figures which might indicate changing financial circumstances, and any contingent issues, whether internal or external to the organisation, which might alter materially the finances of the organisation. This latter requirement would usually be fulfilled by consideration of any Financial Condition Report.

- 5.5** The remit of the Working Party was to examine existing systems of monitoring, not to discover specific existing professional problems. Thus the proposals in the paper do not attempt to cope retrospectively with any particular past problems for the profession. They take into account, however, the reactive nature of the existing systems, and attempt to suggest the adoption of more proactive systems.

6 How could we do it?

The Working Party considered all the following suggested proposals for monitoring. It was recognised that firms and life offices vary in nature and size and so no universal series of measures or solutions would be practicable.

6.1 Internal Compliance Review

This process is defined for the purposes of this paper as being an ongoing review of work done by a member of the profession by a fellow member working within the same firm or life office. Checking would take the form of ensuring compliance with professional guidelines, not checking that the figurework was correct. Only documents setting out advice to clients would be reviewed. It would be carried out on a day to day basis on every document produced which contained actuarial advice.

There would be a requirement on the firm or life office to have in place a standard procedure for reviewing and checking work. If this proposal was adopted, the Practice Boards would be asked to draw up core compliance review standards.

6.2 Internal Actuarial Audit

This process is defined, for the purposes of this report, as a review of a sample of work done by another member of the profession working within the same firm or life office and wherever possible, by a holder of a practising certificate. It would be carried out on an annual basis. The 'auditor' would be given a list of the clients and projects worked on during the year, and would select certain of these. The auditor would be supplied with the files, and he would review those files, using a check list, to check for compliance with professional standards.

6.3 Compliance Questionnaire

The definition of this questionnaire would be similar to that used by the Canadian taskforce. It would have 3 purposes - education, monitoring and feedback of views on professional matters. The education aspects involve reminding members of the professional guidelines to which they should be adhering. The monitoring aspects allow the profession to gauge the extent of compliance. Actuaries may not always disclose whether compliance has been properly implemented, but it will have brought the matter to their attention, and compliance is more likely on a future occasion.

By creating a route for feedback of views on professional matters, it would be helpful to the profession in deciding what changes to professional guidance might be appropriate in the light of practical issues in the application of the existing guidance.

Compliance questionnaires could be completed by all actuaries, but the working party felt that a return of a compliance questionnaire could be mandatory for actuaries applying for Practising Certificates.

The compliance questionnaire for a particular practice area would be designed by the relevant Practice Board

6.4 Annual Report from the Senior Actuary of a firm

This paper on professional matters in his firm or life office would be made by a Senior Actuary in a firm. This would be the Senior Actuary as defined in the PCS, if such a

post exists. The format of the paper would also need to be designed, but it should, naturally, include reporting on adherence to professional guidance. This might be the means by which non-compliance with Guidance Notes, as reported to clients (see 5.3, above), could be reported to the profession.

6.5 Client Questionnaire

Following a suggestion from the General Insurance Board, this suggestion was considered by the working party. Feedback from clients is an important part of quality control and may be relevant to public perception of the profession. The working party considered that, in the rather narrower field of compliance with professional standards, most clients would not be able to differentiate between that subject against general service issues. A good deal of thought would be required in preparing any questionnaire in this area and it was considered the Practice Boards should determine if it was appropriate for their areas of work.

6.6 Compliance Certificate

The concept of a compliance certificate has emerged from the life board actuaries considering the future of the appointed actuary regime with the FSA. The suggestion is that these certificates should be issued to those who wish to apply for, or renew, a practising certificate. The actuary would be required to certify that he holds such a compliance certificate. This idea could be of wider application to all the fields as well as to the life area. If this was based purely on a practice review, it could be issued by the authorised reviewer, but it might be more appropriate for it to be issued by the profession based on the appropriate mixture of compliance monitoring procedures. The issuing of these certificates would be the responsibility of a committee of the profession.

6.7 Practice Review

The definition of this type of review is the same as used by the Canadian task force. It would involve a sample monitoring of a limited number of actuaries. It would be undertaken by members of the profession. The way that it would be carried out, however, would be similar to the internal actuarial audit referred to above. While it would not be an exhaustive practice review, a review cycle would be agreed for firms and life offices and all members would know that there was a possibility of one or more of their cases being subject to review, and this in itself would concentrate their minds. This approach could be controversial due to confidentiality of reports. Two possible approaches to providing the practice review are set out below.

6.7.1 Team appointed by the profession

One model considered involved the appointment by the profession of a team of reviewers. These would need to be qualified actuaries with experience in the particular field being reviewed. It was considered that actuaries very recently retired from main stream work, but who keep up to date by attendance at CPD events, would be possible candidates for this role. The reviewer would not

necessarily hold a practising certificate for the relevant area, but would be someone for whom the provision of such a certificate would be unquestioned.

6.7.2 External firms

Actuaries appointed by other firms could provide this service. The firms that employed these actuaries, or of which the actuaries were partners could be firms of consulting actuaries, or have a substantial actuarial department (e.g. an auditing firm). This approach and the one mentioned above operating together would allow a market to develop between the actuarial consultancies, audit firms and the profession's team, allowing the cost of peer review to find its market level.

6.8 Practice Review of Appointed Actuaries, and their supporting actuaries in life offices

This area proved the most controversial subject considered by the working party. Many views were expressed publicly and in private to members of the working party. While some of the methods given above might be appropriate in many circumstances there may be situations where external audit is the only route. The Life Board of the profession is working with the FSA to determine whether the current form of Appointed Actuary system can be integrated within the new environment. The need for an effective robust compliance review process forms part of that discussion.

The work of appointed actuaries is already more subject to informed external scrutiny than is that of most other actuaries subject to mandatory guidance. Section 5.4.1 explains the work done by GAD. This work does not normally extend to monitoring those parts of GN1 and GN8 which are not reflected in Schedule 4. Most firms of auditors now use an actuary to scrutinise the accounts prepared under the Companies Acts regime, and as part of this they normally discuss the statutory valuation basis with the Appointed Actuary. In addition, many companies also use external firms of consulting actuaries to advise on the value of the business in force and again they will normally discuss the basis with the Appointed Actuary. In forming our proposals we were well aware of this fairly heavy burden and are anxious to avoid it being exacerbated. Hence our proposals suggest that the practice review could become an extension of work already carried out by one or other of those external parties, where appropriate. This does not, of course, preclude the work being carried out by other parties if felt to be more appropriate.

In considering the role of the Appointed Actuary under the new supervisory regime, the life board produced a paper (The Role of the Appointed Actuary under the New Supervisory Regime). This was produced in connection with discussions with the FSA in June 1998. The following paragraph - Section 6.2 of that report is quoted below.

It has also been suggested that FSA may wish to carry out quality control of the Appointed Actuary's work. We support, in principle, the idea that the profession

should be able and willing to carry out an effective audit when necessary. We believe that this would help to resolve a perceived conflict in the current position (since it could confirm the employed Appointed Actuary's freedom from inappropriate influence from the business). We believe that it is important that this monitoring task is outsourced from FSA either to the profession or to the Civil Service (presumably the Government Actuary's Department). We also believe that it is important that such a review of the Appointed Actuary's work should be about matters of financial significance to the company or to its customers (as individuals) rather than concerned with the detail of regulation.

In line with the thoughts expressed above, there were 4 approaches to external monitoring considered by the Working Party. These are set out below:-

6.8.1 Extension of the role of the Government Actuary's Department

At present GAD has responsibility to the Government to supervise clearly defined aspects of the running of life offices. The proposal being made here is for an extension of that role, but in a different direction. The proposed role would involve the GAD reporting to the profession as well as the Government. This role would be different and distinct from the one it carries out for the Government. However, the two roles could be carried out in conjunction, leading to economies of scale.

Complimenting the role to ensure that all relevant professional standards have been adhered to would be, in the view of the Working Party, an appropriate and satisfactory extension of their existing role. We endorse the principle in the paper of the life board referred to above that there should be effective monitoring of the work of the Appointed Actuary. This should include verification that all professional standards have been adhered to. It would therefore be proper to invite the GAD to extend their review of the actuary's work on behalf of the FSA to include a specific review for the profession of whether professional standards had been properly observed in all areas. There would, however, need to be further consideration of the scope of the review, and whether any potential infringements would be referred to the profession or to the FSA for possible further action (given that the actuary is required to certify to FSA that certain mandatory Guidance Notes i.e. GN1 and GN8 have been complied with). It will be necessary formerly to ask the GAD to take on this role, if the profession decides that this is the proper course.

6.8.2 Extension of the Audit Firm's Role

An alternative suggestion relates to the role currently carried out by actuaries employed by the firms carrying out the audit of the life office's financial affairs. At present these actuaries assist the accounting partners carrying out the audit by reviewing the relevant actuarial work. The role of these actuaries could be extended, by asking them to report on compliance with professional actuarial standards. Such a review could take place at a different point in the

year from the main audit work. In the view of some actuaries this would have serious consequences on the role of the Appointed Actuary. An external audit review of all actuarial work, including confidential reports to the Board of the life office could involve fundamental changes to the role of the Appointed Actuary and the structure of our profession and this would not necessarily be desirable as it might diminish the role of the Appointed Actuary.

6.8.3 Use of External Consulting Actuaries

The use of a separate consultancy firm which carries out work of a life office nature would be appropriate as a further alternative. This firm might, or might not be involved in giving consultancy advice to the life office in question. Nevertheless, as for the GAD and the audit firm above, this particular role would be carried out on behalf of the profession.

6.8.4 Use of the Team Appointed by the Profession

This last alternative could also be available. Naturally the reviewers would be those familiar with life office practice, and to whom the practising certificates committee has, or would have granted a practising certificate, had such application been made.

7 Horses for Courses: Appropriateness of the Various Methods

The Working Party then considered the appropriateness of the various methods.

7.1 Internal Compliance Review

This method of monitoring is expected to be easy to introduce for consultancies. The method lends itself to firms with a number of actuaries advising in the same area. It was also felt appropriate for life offices with relatively large valuation departments where several actuaries with considerable experience were assisting in the preparation of the returns for the regulatory authorities and for reporting under the Companies Act. This method was less appropriate for small firms where there might be only one experienced actuary.

7.2 Internal Actuarial Audit

The application of this method would be similar to that for internal compliance review mentioned above. For both these methods, special situations arise for sole practitioners, or firms with a very small number of actuaries. Reciprocal arrangements could be set up, as already exists in some circumstances, between small firms. These firms would, naturally, need to trust each other not to poach business from each other. It would also be necessary to alter the terms of contract between clients and actuarial firms to acknowledge that the work might be reviewed by employees or partners of another organisation.

This approach would have more limited application in life office situations, but both a peer review and actuarial audit should be applicable to pension scheme actuary work done in a life office.

7.3 Questionnaire

Consideration was given to compliance questionnaires forming part of the Practising Certificates application form. However, it was felt, after some discussion, best to keep the matter of Practising Certificates separate from the return of questionnaires for timing and resource reasons. It was agreed that members should be required to have submitted the questionnaire within 12 months of renewal thus giving the Practising Certificates Committee the opportunity to consider any areas of possible concern in advance of the next application. Initially, these questionnaires are likely to be appropriate only for Appointed Actuaries, Scheme Actuaries and holders of the new Lloyds' certificates.

A broad outline of a compliance questionnaire would be prepared, but it would be for the Practice Boards to prepare the detailed questions relevant to their own areas. The role of the Professional Affairs Board would be to ensure consistency across all boards.

The questionnaire would have to be designed in such a manner that the professions' secretariat could, in the first instance, filter out the straightforward ones. There would have to be a committee, similar to the existing Practising Certificates Committee, to review problem questionnaires and flush out the problems.

7.4 Annual General Report from the Senior Actuary

It would be necessary to identify the Senior Actuary within firms and life offices. The paper would include items relevant to the firm or life office in question. Clearly the response from a sole practitioner would be substantially different to that from a life office.

7.5 Compliance Certificate

The Committee referred to above in Section 7.3 is likely to be the appropriate body to issue the compliance certificates.

7.6 Practice Review

It was felt that the existence of this review would concentrate minds on tightening up standards. The frequency of practice review might be determined by the existence or otherwise of the internal compliance review, and internal actuarial audits, and reports by the Senior Actuary. Practice reviews would be limited by cost and availability of suitable reviewers. These would have to be on a very selective and sample basis at least at the start.

7.7 Life Office Actuary Monitoring

The monitoring of an Appointed Actuary in addition to method 6.1 to 6.4 where appropriate, would be supplemented by a practice review as set out in Section 6.7 using one of the approaches of Sections 6.8.1 – 6.8.4 referred to above, at the choice of the life office. Practice review of other actuaries, such as the reporting actuary, might not be appropriate at this stage as his/her work may not be subject to mandatory guidance. Attention might be given to GN22 on disclosure and at some stage in the future the whole question of product design and marketing, particularly as far as it relates to PRE. Examples might be the role of the reporting actuary and those involved in product design and marketing.

7.8 General Insurance Actuary

The methods described in paragraphs 7.1 – 7.6 would be appropriate for actuaries working for external firms who are asked to provide a report or certificate for a general insurance company or Lloyds syndicate. For actuaries directly employed by an insurance company or managing agent, then the approach described in paragraphs 6.8.1 – 6.8.4 above could also be relevant in respect of any formal reports or certificates produced by the actuary. For other assignments undertaken by employed actuaries for their own firms then paragraphs 7.1 and 7.2 above could be relevant for monitoring compliance with PCS and any relevant Guidance Notes.

7.9 Pensions Actuary Monitoring

There are a considerable number of Guidance Notes which need to be monitored, the most important of which are GN9 and GN11 and all those arising under the Pensions Act. All the methods described in 7.1 to 7.6 would be appropriate. However there may be practical problems for small consultancies and the pensions departments of life offices where lack of resources may dictate the need for external audit in order to satisfy the profession's requirements. It is however important that all firms whatever their size fall within the ambit of the proposals.

8 Pilot Testing

The working party believes that pilot testing of the Practice Review process is both appropriate and necessary. A formal pilot testing exercise will enable regular two-way feedback between the membership, the responsible Standing Committee (see Section 12.2) of the Professional Affairs Board which we envisage will be in charge of the project. It will therefore help to build confidence on the part of members that their views will be constructive in developing the processes that will ultimately emerge. It will also ensure that the final processes which emerge are truly workable.

Pilot testing could be carried out on a voluntary basis initially. Any non-compliance discovered during this process should be dealt with on a sensitive and supportive basis. The Professional Affairs Board will need to give guidance as to how to handle the unlikely event that a serious problem of non-compliance could be discovered, and may consider an exemption under Section 2.9 of the Professional Conduct Standard for this purpose. This

would avoid an automatic formal complaint against a member who had volunteered for the pilot, and where monitoring indicated a problem. It is likely that these exemptions would apply only to the pilot cases, and not to subsequent monitoring.

It will be helpful if the firms and life offices and individuals who volunteer for pilot testing comprise a good range of size and type of firm and life office, so as to represent, as far as possible, the full range of firms/life and general insurance offices/individuals who will ultimately be subject to the finalised procedures. Further thought will need to be given as to how to encourage such a spread of volunteers.

9 Costs

9.1 Internal Compliance Review and Internal Actuarial Audit

The additional costs within a firm or life or general insurance office would relate to the number of hours another actuary would spend reviewing work and the extent to which similar reviews already take place. In respect of the internal actuarial audit, this would be between half a day and a day for each qualified actuary being reviewed, and in respect of the internal compliance review would be between quarter of an hour and at most 2 hours depending on the size of the document being reviewed. These times could be multiplied in the case of consulting firms by typical charge out rates (between £160 and £250 an hour for consultancies) to arrive at the cost.

9.2 Fees for the services of Reviewing Actuaries

These actuaries might be retired actuaries, or possibly, in some instances, staff actuaries of the Secretariat. The fees are likely to be of the order of £500 a day.

9.3 Outside Audit firm for Life Office Review Work

The cost of such a review is difficult to estimate without specific terms of reference, and will vary according to the complexity of the office.

We estimate that the time spent conducting such a review for a medium sized office might be of the order of one man week assuming that the audit firm is already responsible for the external firm of the life office involved.

9.4 Secretariat Fees for Reviewing Questionnaires

It is envisaged that this function will fall under the ambit of the Professional Affairs Board and would initially either be subsumed into the existing Practising Certificates Committee (albeit that perhaps a smaller sub-group will be formed to deal with problem questionnaires) or subsumed into the existing Compliance Committee. Initially only those Actuaries requiring Practising Certificates will be asked to complete a questionnaire and the information would primarily be sourced by the Practising Certificates Committee when reviewing applications for certificates.

There are presently circa 800 Scheme Actuaries, 160 Appointed Actuaries and it is assumed that there will be circa 100 actuaries requiring Practising Certificates for

issuing Lloyd's Opinions. In total, therefore, there are likely to be an initial 1000 questionnaires per annum to examine. Until the length and content of the questionnaire is determined, it is not possible to accurately scope the additional work involved but assuming an average of 15 minutes to review and action a questionnaire (based on an assumption that the majority will be straightforward and only a minority will require additional investigation) this equates to about 5 hours per week.

This would require to be found from within existing resources. If this was subsumed into an existing committee then there would be minimal additional outlays. If the questionnaire was extended to all members of the profession however it will have a major impact on resources which would have to be reviewed in light of the experience and feedback from dealing with Practising Certificate holders only.

10 Recommendations for Discussion

The working party recommends the following procedures for monitoring compliance. They fall into 3 stages.

10.1 Stage 1

It is anticipated that stage 1 would last for 1 - 2 years after implementation.

Internal compliance review and internal actuarial audit, along guidelines provided by the profession, should be put in place as soon as practicable by firms and life offices on a voluntary basis and this will be actively promoted by the profession. A compliance questionnaire prepared by the profession should be compulsory for members applying for, or reapplying for Practising Certificates. An annual report from the Senior Actuary should also be compulsory for firms and life offices where such a post exists and firmly recommended in all cases.

Pilot testing of practice review should take place during stage 1. Firms and life offices should be asked to volunteer to participate in the pilot testing. Unless very severe problems were found with such firms and life offices they could expect to be put at the end of the list for future practice reviews.

10.2 Stage 2

This should commence after the pilot testing carried out in Stage 1 has been reviewed. Internal compliance review and internal actuarial audit should continue on a voluntary basis, and practice reviews should be introduced on a wider basis possibly using a team employed by the profession. The review would include a decision for which practices or fields compulsory practice review should be introduced and the precise timescale for its introduction. A cycle of 3 years would be appropriate for life offices, carried out by the profession's team, Government Actuary's Department or an external firm, at the choice of the life office. Priority for practice review would be given to firms and life offices without adequate internal procedures.

The details of implementing stage 2 might alter as a result of feedback from the pilot testing.

10.3 Stage 3

A review of procedures should be conducted by the Professional Affairs Board after an appropriate time to see how they are working (no longer than four years after implementation of Stage 1).

11 Need for Publicity

11.1 Taking the Profession with us.

For the proposals to succeed the goodwill and co-operation of the membership as a whole will be essential.

The suggestions made in this paper for monitoring compliance represent a significant change from the existing methods used. The existing methods (see Section 5 above) represent largely a reactive approach, whereby generally the Compliance Committee of the Professional Affairs Board merely responds to complaints or referrals put to it.

The recommendations made by the working party on the other hand (see Section 10 above), will, if adopted in the way suggested in this paper change the monitoring process to a much more proactive approach. Individual actuaries and their actuarial colleagues will become formally accountable for the internal compliance review and internal actuarial audit processes envisaged in Stage 1 (see paragraph 10.1). Although these internal processes will apply on a voluntary basis it is expected that many members will adopt them as part of good business practice. It is envisaged that the Senior Actuary report will be compulsory under Stage 1 and the practice review process will apply on a compulsory basis under Stage 2. The latter will bring in external Actuaries to review the professional practices of the firm and its individual actuaries. Moreover, this paper recommends that the completion of compliance questionnaires will be compulsory for actuaries applying or reapplying for Practising Certificates from Stage 1.

The working party believes that these recommendations are necessary to achieve the objectives set out in Section 2 of this paper. It is believed that they should not be too onerous to operate. For a number of firms they will do little more than formalise existing good practices. Nevertheless, these recommendations will involve significant change to current procedures operated by the profession. The fact of change, the additional compliance workload which will result (although the working party hopes that this will not be significant) and a natural resistance to having one's own work inspected by others under practice review (in particular by actuaries external to the actuary's own firm), might be unwelcome to some. In addition, the Working Party appreciates that firms and life offices may be concerned about confidentiality being maintained and the costs of practice review.

While our proposals are considered to be in the best interests of the profession, the working party accepts that a negative reaction is possible, at least initially. It hopes, however, that the steps set out below will help to reduce this reaction and, instead,

encourage the approval and co-operation of the membership as a whole to the processes recommended. Clearly it is crucial for the success of these compliance monitoring procedures and thus the achievement of the underlying objectives, that the membership agrees and works with them.

The Professional Affairs Board and FIMC have agreed the Working Party's recommendation, that the following steps should be implemented.

- There should be (and be seen to be) transparency and openness with the membership from those in charge of the project each step of the way.
- The issue needs widespread consultation amongst the membership of the profession and should be the subject of a discussion paper presented at a Sessional Meeting (Faculty and Institute).
- Such open communications should be continued by the responsible Standing Committee of the Professional Affairs Board throughout all the key stages of the initiative. As noted above, the co-operation of the membership is crucial to its success - the purpose of this communications exercise will therefore be to give and receive regular feedback on how the project is implemented. This contact with the membership will need to demonstrate effectively that the reactions and suggestions of members are important and will be considered carefully by those in charge of the project. This will help to build confidence on the part of the membership in the processes that will be put into place. This part of the process could be tailored more closely to the specific areas and needs of the Practice Boards. For example, the issue would be included for practice-specific discussion at the specialist conferences of the Practice Boards.
- Communications with the membership will be reinforced by separate formal pilot testing of the practice review for compliance monitoring. Firms and life offices will be asked to volunteer to participate in the pilot testing exercise (see Section 8 above).

11.2 Explaining to the Public

A key objective of the initiative is that the profession should be, and be seen to be, more accountable to the public (see paragraphs 2.6 above). This is all the more important given that we are essentially dealing with the monitoring of our professional code rather than more public issues like life product design and pension mis-selling.

As the project gets underway, it will be helpful to find ways to publicise the initiative externally, so as to inform the public as to the important steps being taken by the profession with respect to this compliance monitoring initiative. This part of the project should be referred to the Public Relations Committee to develop further.

The Working Party feels, however, that the public relations aspects of this initiative will need to be handled carefully, sensitively and positively. There is a risk that, unless successfully presented, we might achieve the opposite of what we intend.

This could arise, for example, if those who are suspicious of actuaries see the initiative too much as a defensive move on the part of the profession, or even as the manifestation of a lack of confidence on the part of the profession's governing body, in the ability of actuaries to do their jobs properly and professionally.

Again, this is an aspect which should be referred to the Public Relations Committee to consider further.

12 Work Required

- 12.1** Practice Boards should be asked to produce standard compliance review and actuarial audit forms based on the draft generic audit form and draft generic compliance review form attached as Form 1 and Form 2 respectively, and a relevant compliance questionnaire based on the generic questionnaire attached as Form 3.

A draft standard Senior Actuary report based on the draft attached as Form 4 will also be needed, to be drafted by the Professional Affairs Board and reviewed by each Board before implementation, as well as a list of points to be covered in a practice review and a standard practice review report.

These items should be based on the suggestions in this paper, and could draw further upon the experience of the Canadian actuarial profession's documents and those used by UK200.

The Professional Affairs Board should oversee the above documents produced by the Practice Boards to ensure consistency among them.

- 12.2** Professional Affairs Board should also set up a Standing Committee to oversee procedures and a Compliance Questionnaire Committee (separate if necessary).

The Secretariat needs to budget resources to run the committee and other aspects of the regime outlined, including production of the standard materials referred to above. The Charter Rules and Byelaws Committee should consider what changes would be required by the new arrangements.

- 12.3** The Professional Affairs Board needs to consider how to manage and monitor the progression of the recommendations.

- 12.4** The Practice Boards may wish to consider areas for future monitoring (e.g. the Pensions Board may wish to consider Section 67 Certificates and the Life Board may wish to consider product development and growth rates in premium calculations).

12.5 Who Pays?

We have not at this stage considered the issue of who would pay for the costs discussed above, but would draw to the attention to the fact that substantial costs to the Institute and the Faculty could arise.

In particular it will be necessary to address the question of who pays for external reviews. This might be the profession, who might seek payment from members and in turn recompense any members or team carrying out external reviews.

13 Conclusion

The ideas and proposals set out in this paper are submitted to the profession for consideration as a package of measures to achieve the objective set out in the terms of reference.

The working party has already taken steps to obtain the views of employers of actuaries in this area. The purpose of this paper is to stimulate discussion among the whole of the actuarial profession in the UK on this subject. Views on all aspects are very welcome, but as an aid to debate, the following questions might be discussed.

- 13.1** Whether the review should monitor the quality of advice given as well as adherence to specific guidance.
- 13.2** Whether practice reviews should be introduced on a compulsory basis, or on a voluntary basis as proposed by the Institute of Chartered Accountants in England & Wales.
- 13.3** Whether monitoring of life office actuaries should be an extension of activities already carried out, either by GAD or others, or whether a completely separate review is desirable.
- 13.4** Whether the completion of a compliance questionnaire would form an appropriate conduit of information and problems relating to actuaries in the relevant field
- 13.5** How the issues of confidentiality between an actuary and his client or employer can be dealt with, where a third party has sight of the advice provided.
- 13.6** How to deal with the issues arising when an actuary carrying out a practice review for the profession comes across a major problem which, according to the Professional Conduct Standard should be reported as an example of professional misconduct. Whether to deal in different ways with problems under this heading, arising under the pilot testing, and those arising after full implementation.
- 13.7** Who should pay the costs of the monitoring of compliance and how much would a practice review cost for the different kinds of projects in which actuaries advise.

Appendix A1

Are standards understood?

Canadian Institute considers practice review process

An article by Robert J. McKay published in the January 1999 edition of *The Actuary* - the Newsletter of the Society of Actuaries

During the second half of 1998, members of the Canadian Institute of Actuaries (CIA) debated implementing an "inspection system" for the profession in Canada. The proposed system was described in the report of the CIA Task Force on Compliance Review. Because of significant opposition to the details of the proposal, the CIA is now reviewing other alternatives for practice review, including implementing parts but not all of the inspection system model.

The task force's report was issued in July 1998 and has been discussed and debated in town hall meetings. Although the task force proposal for practice review is likely to be modified based on comments from these meetings, the current proposals may be instructive for SOA members.

The term "practice review" refers to the actuary's total practice. This differs from peer review, in which a specific piece of work is examined. Alternatives to practice review include compulsory peer review and detailed annual questionnaires on compliance, ideas the CIA might consider in the coming months. The CIA implemented a questionnaire several years ago; one option might be to expand this instead of implementing a full practice review.

During the town hall meetings, many actuaries asked what problems would be solved by practice review. The concerns raised by the task force are unique neither to Canada nor to North America. Peter Morse, CIA president, responded at a November meeting of the CIA membership:

In order to be in a position to respond to increasing concerns expressed regarding the range of practice of actuaries in some practice areas, the profession needs to be aware of whether the standards are being understood and followed and to discover where the standards are deficient. In addition, education of our members concerning the range of practice is also perceived to be a responsibility of the profession.

He went on to say, "To suggest that no action is necessary because 'we are actuaries, and each of us as individuals knows best' [as one member put it at a town hall meeting, 'Let the regulators send any case they don't like to Discipline' (the CIA Committee on Professional Conduct)] will get us nowhere and could lead to regulators and legislators taking control of areas which we consider as our domain."

Why did the task force feel that the CIA should take this major step? It identified several potential benefits of a practice review policy. Such a policy would:

- Ensure that members understand proper actuarial standards and the application of those standards to their work.
- Identify areas where standards are deficient or unworkable.
- Bring about changes in practice by persuasion where wide variations of practice in similar circumstances are discovered.
- Call the situation to the attention of the CIA Committee on Professional Conduct, where matters are discovered that question the competence or integrity of the practitioner.

The task force concluded that practice review should only apply to work in Canada by a member in support of the member's public actuarial opinions. This would include actuarial opinions in published documents, plus all opinions of an actuarial nature that are required to be provided by a Fellow of the CIA, that must be filed with a Canadian regulator, or that may be included as evidence by parties to a lawsuit.

The task force developed a proposed review system that includes two levels of review. Tier one would be an annual questionnaire for all practice areas. Tier two, the more controversial recommendation, would be an in-office review of practices and procedures for the practice unit on a random cycle. The task force expects that a review would involve up to 50 hours of time. Tier two reviews would be initiated either as a result of information discovered in a tier one review or by random selection. All practice units would be visited at least once every five years.

A major concern among practitioners is who would conduct reviews. With only about 2,000 actuaries in Canada, conflicts of interest and professional competitive practices are real concerns. To address this, the report stated that the CIA should hire a staff actuary to support the development of detailed procedures and to provide day-to-day management of the process.

The task force also recommended that persons engaged by the CIA should conduct all practice reviews. It also stated that reviewers must not be active practitioners or at least have no conflicts of interest with the practice unit, its members, or the cases being reviewed. It also recommended that the CIA Committee on Practice Review should have no knowledge of the identity of the practitioners or client files associated with a given review.

The task force stated that the in-office practice reviewer should be able to request any detailed information necessary to support a review of a practitioner's work. In some cases, this could require additional calculations or other tasks. Members should be required by rules of professional conduct to co-operate with the practice review process.

In a recent note to CIA members, Morse summarised the major criticism of the proposals. These included the seemingly intrusive nature of the proposed processes; the estimated cost of the program compared to perceived added value to the membership; the perceived lack of sufficient numbers of competent yet independent reviewers; the burden such reviews would

place on the practice unit, particularly for small operations and sole practitioners; and the lack of a demonstrated need for the process in those practice areas where robust peer review practices are already in place. According to Morse, member reaction tended to be more negative among pension actuaries than those working in insurance, and reaction was strongly negative among actuaries working in small practices.

While the final form of practice review in Canada may differ from the current recommendations, it is likely that the CIA will eventually implement some form of review. And the concerns raised by the task force are unique neither to Canada nor to North America. In his presidential address, Paul Thornton, 1998-2000 president of the Institute of Actuaries, observed:

Professional judgment used to mean that with skill and experience, the professional knew best - and at one time, professional judgment would have been accepted without question. We now live in an era where professional judgment is under challenge in a way in which it was not in the past, and we will retain respect as a profession only to the extent to which we earn it and keep re-earning it.

Robert J. McKay, consultant, Hewitt Associates, Toronto, is an associate editor of *The Actuary*.

Appendix A2

Whither Practice Review?

An article by Paul F. Della Penna, published in the May 1999 edition of the Canadian Institute of Actuaries Bulletin.

The topic of practice review has received a lot of attention in the past few months in general meetings, regional "town hall" meetings and on the general list. The Task Force on Professional Conduct (TFPC) was handed the task of digesting member input to the recommendations (for the Institute's adoption of a program of practice review) released last August by the Task Force on Compliance Review. In all, ten regional meetings were held. Member response to the proposed initiative ranged from lukewarm to hostile. Also, a total of 56 individuals returned the questionnaires that we distributed. In response to the single question whether the recommended program should be adopted ASAP or within three years or five years or never, of 33 pension practitioners, 23 said "never," while of the 17 life respondents, seven said "ASAP" and seven gave no answer.

Given this response, Council revised the mandate of the TFPC to make it clear that we were under no obligation to implement the practice review recommendations. They also asked us to explore alternatives that would give a greater emphasis to education. While the task force has reached no conclusions as yet, we are anxious to put some of these thoughts before you in advance of the annual meeting in June, and this Bulletin article seemed to be the most practical way of doing so.

What We Shouldn't Do

One idea that appeals to a number of actuaries is that, since the life actuaries were generally supportive of practice review, and since OSIFI is pressing us in this practice area we should adopt practice review only for life actuaries. By practice review, I mean a process that involves a review of a practitioner's work by a representative of the professional body responsible.

I believe that it is a fundamental error to consider having a form of practice inspection by whatever name for some actuaries but not for others. It is okay to define a certain type of work (e.g., public opinions), but it makes no sense to single out life actuaries, in-house actuaries, male actuaries, actuaries over 60, sole practitioners, or any other subset. For the CIA to adopt practice review for life actuaries and not for others immediately raises the question, why them? Is it because we have doubts about the quality of their work? Is it because their work is more important than that of others? Of course, there are other ways of interpreting such an initiative that reflect equally unfavorably on the Institute (e.g., we impose requirements like practice review only on members who don't object to it, or only to those areas of practice where regulators are especially demanding). On the other hand, CIA initiatives of this nature that apply to all actuaries are quite easily explained as being

motivated by the desire to make continual improvements to a product that is already of high quality.

Please remember that OSFI is encouraging the CIA to introduce a peer/practice review system for all practice areas, starting with life actuaries. Rather than introduce practice review for life actuaries only, it is better to tell them now that we cannot proceed without the substantial support of our members, but that we can do "something else."

What We Should Do

The "something else" that the task force is now studying is peer review, mandatory for public opinions (after a suitable transition period) and voluntary for other work, with CIA guidelines (standards?) for peer review. This is a giant step forward. The CIA today does not encourage or require peer review, nor does it have any guidelines. Yet the majority of our members already utilize peer review, as many of you pointed out in the regional meetings. It makes sense to build on that in order to promote quality work and to be perceived as doing so.

How does peer review differ from practice review? It is easy to become confused, particularly since some professional bodies use one term to mean the other. To me, the key distinction is that practice review is an official CIA act. It is always post release and deliberately so. Its subject is the practice of a member or a group of members. On the other hand, peer review is something that members arrange themselves. It is commonly pre-release and addresses a specific report or opinion. There are a number of variations of both practice review and peer review.

The task force is currently discussing how such a peer review system might operate among members of the Institute. In addition to consulting our members, the TFPC will be consulting a number of published reference works to help us as we go, but so far, we have identified some elements of a peer review process that could suit our needs.

1. Peer review, especially in connection with public opinions, is something that applies to the member who takes responsibility for specific work. While a number of different actuaries may have participated in that work, a separate peer review would not be required of each participating actuary's work. Only one peer review(er) would apply to all the work supporting the opinion.
2. Peer review is not about checking calculations and verifying data. It is good practice for the practitioner to do those things or have them done. One task of the peer reviewer should be to review the evidence of that (e.g., by confirming that someone has signed off as checker).
3. The peer reviewer should meet the same test of competence for the work as the practitioner and should be capable of performing a review objectively without being unduly influenced by the practitioner. Expressed that way, it is evident that internal peer reviews are okay, provided that a qualified reviewer can be found internally.

4. While pre-release reviews are desirable because it is easier at that stage to deal with issues arising, on review, mandatory reviews for public opinions may be conducted on a post-release basis, provided that the review takes place within a reasonably short time.

Other specific issues that the task force is discussing include (1) the acceptability as a substitute for peer review of two or more actuaries taking responsibility for the work, and (2) how to deal in a practical way with the work of actuaries who produce a large volume of very similar, brief reports.

Where external reviews are necessary, there is a concern that it could be too costly, and the profession needs to be sensitive to that. Of course, costs can be expected to decrease over time if the same reviewer is used for several years. A number of sole practitioners have told us that they now have mutually satisfactory peer review arrangements with other sole practitioners. However, if CIA peer review guidelines are perceived as being too onerous, this is an area where problems might arise. In-house insurance actuaries will also be concerned about the cost of external reviews, and the profession must be sensitive to that too.

In accordance with the CIA's Statement of Purpose, which states that our actuarial services and advice provided to the public will be of the highest quality, our Profession should seek to have good peer review practices become habitual across the profession, and then work over the years to gradually improve upon them. I believe that this is a goal all actuaries can share. The experience of those who practice it demonstrates that peer review improves the quality of our work, not only that of the practitioner, but also that of the peer reviewer. We all learn in the process.

Apart from peer review, our task force supports the recommendation that the existing compliance questionnaires be enhanced and changed to diminish the emphasis on compliance. They should focus instead on the handling of specific issues of importance so that all members can have a better perception of the range of practice "out there." The compliance questionnaires can also be used to help the practice committees gather information on the application of standards as input to the process of standards development.

Paul F. Della Penna, FCIA, is chairperson of the Task Force on Professional Conduct.

Appendix B

UK Accountancy Profession – Compliance Monitoring

In Section 4.3.1 of the paper, reference is made to the role of UK200 and the JMU in monitoring compliance of members of the accounting profession. Information obtained from a meeting with representatives of UK 200 is set out in this appendix.

UK200 require an annual return from their member firms. The reviewer arrives armed with the completed return / questionnaire, and also last year's report. There is also a comprehensive checklist and manual. These items are in both paper and electronic format as required. The lists are both of the tickbox and short commentary variety. Internal Monitoring (of Audit regulations set by ICAEW) of 2-3 cases per partner per year is carried out. Small firms have mutual agreements with other small firms to review each other's work. UK200 reviewers look at the in-house reviews. They review the same files and reassess them, as well as conducting further reviews. The selection of cases is done by the reviewer, with highest risk cases first. Selection is from a list supplied by the firm. The process is carried out by interviewing as well as by looking at files.

UK200 awards grades for the quality of work done. For individual partners, these range from 1-5 (1 is best, 5 is worst). Most audits are 2s and 3s. Action is taken on the very few 4s. There are virtually no 1s. In addition an award is given for the firm overall. These range from A down to E. Most firms get B (but gradings of B+ and B- are possible). If a 4 is given, there is an investigation into further cases. There is then a quarterly summary of performance. If a firm fails the grade, it is removed from membership. This only occurs, however, after a warning review, following which a firm is entitled to help.

All audit work is monitored, and the reviewers are all experienced in this area. Other work is reviewed, but it is accepted that the reviewers may not have as much expertise in speciality area as the professional under review. Examples might be pension scheme audits, and share valuation work. There are specialist checklists for these.

Costs were initially covered entirely by commission from PI insurance. Most recently, however, two thirds come from this source, and the balance is paid for by the firm. The total fees are £215 per day for the reviewer and £190 per case by the administrator. The number of days depends on the size of firm. For small firms a day per partner would be appropriate, but this reduces with size of firm. For a 2 man firm the cost would be about £500 in total, so a firm would contribute less than £200.

JMU

Turning to the procedures for the JMU, typically, for a small firm, the JMU visit occurs about every 4-5 years. There is also an annual return for JMU of 30-40 pages. The results are analysed by computer - so called "desk top monitoring" – to identify high risk areas. JMU reviewers are full time employees – not necessarily older people.

The JMU was, reportedly, “heavy-handed” initially, but changed its style to make it less so. There is concern about the make up of the profession’s ethics committee (and the proposal to switch to having a majority of non-accountants on it). It is accepted, however, that professionals have to keep up to date or “fall out”. There is some concern about the recent proposal for the JMU to make unannounced “knock on the door” visits. This requires files to be kept continuously in good order, rather than tidying them up after the end of a major exercise such as the audit of a substantial company.

UK200 firms (and all firms for JMU purposes) have confidentiality clauses in their engagement letters / service contracts agreeing to external review. This is in small print. The clause says that a file may be selected and reviewed on a confidential basis.

Various examples of UK200 checklists were obtained.

Appendix C

Information from Meeting with JMU held on 5 May 1999

In section 4.3.2 of the paper, reference is made to a meeting with the JMU. Information from that meeting is set out in this Appendix.

JMU explained that all three Institutes of Chartered Accountants had, or were presently seeking to introduce, some form of Practice Review.

ICAI The Irish Institute has had Practice Review in operation for five years. It is carried out on a voluntary basis and Irish Inspectors working for the JMU are involved. A report is submitted to the Irish Institute, however, this does not name the individual firms subject to review.

ICAS at its Special General Meeting on 16 April 1999 approved a compulsory system of “Activities Review”. This applies not just to firms regulated for Audit and/or Investment Business but to all accountancy firms in Scotland. It is being introduced with effect from 1 January 2000. Any firm which is subject to audit or investment business review within 12 months of that date will automatically be subject to a Practice Review at the same time as the Audit and/or Investment Business Review. This will be undertaken by J M U Inspectors. All other firms will be subject to Practice Review to be carried out by Inspectors employed by ICAS but not necessarily with the first 12 months.

Reports from the Inspectors will be submitted to an ICAS Committee who will be able to determine whether or not the firm can continue as a “quality accountancy firm”. All accountancy firms have a “CA mark of quality” on their letterheads and this would disappear in the case of those firms who failed to meet the required Practice Review standard within the first five years of its operation. It would be possible for a firm that failed to obtain the required standard to reapply at anytime within the five years and if successful the quality mark would not be removed.

ICAS see this review as an education programme which will lead to an enhancement in professional standards. It is being operated under the auspices of its Professional Standards Committee. The costs will be recharged to the firms being reviewed.

ICAEW Council has approved a voluntary Practice Review system which will focus on quality control and how this is carried out within practising firms. It should be stressed that, unlike ICAS, this will be voluntary but will also be paid for by the firms subject to review.

It will focus on Practice Management and concentrate on various types of client services where the annual service fee income is 10% or more of the total annual practice fee income. It would also look at any other areas that firms may volunteer and the intention is that up to 50% of the total practice fee income will be reviewed.

As stated it will concentrate on quality of service, unlike Investment Business visits where the quality of advice is also looked at, although JMU admitted this was something of a grey area.

The intention is to make it profitable to firms, marketable and educational and lead to a reduction in PI premiums.

Although plans are still being developed, it is likely that successful firms will be kite marked by the ICAEW and something tangible will appear on the notepaper. Again if the firm fails it would be open to it to reapply. JMU did voice concern of a possible first and second class status emerging between those with the seal of approval and those without, however on balance they consider this should stimulate volunteers.

JMU agreed that firms must know what they have to do to get accreditation and they are looking at producing official guidance to be adopted by Institute Council setting out practice management standards. It is not likely to be exposed to all members. However, as ICAEW is introducing this on a voluntary basis, this is probably not essential. There would however be a pilot study using external quality consultants before the scheme is introduced. It was noted that in Scotland and Ireland no full exposure of relevant guidance to members was undertaken.

The following key areas were discussed against the above general background:-

1. **Kite Marking**

As mentioned ICAS, under its compulsory scheme, intend to remove the CA quality mark from those firms failing to meet the required standard. ICAEW intend to reward successful firms with some tangible stamp of approval which would appear on its notepaper.

2. **Annual Returns**

Annual Returns are currently required by JMU in carrying out Investment Business and Audit Reviews. It would be intended to apply this to Practice Review. The purpose is to ensure that firms are carrying out annual internal quality control reviews and detailed help sheets are made available to firms as an aide memoire for matters to be considered when conducting a whole firm review. This annual return is signed off by the Compliance Officer and is then run through JMU's internal risk assessment programme to determine whether or not it might be appropriate to conduct a review outwith the normal three year review cycle. It should be noted that the major firms are inspected annually as it is regarded as being in the public interest to do so.

When Inspectors visit firms to check internal processes they re-perform some of the work to check the same conclusions are reached. In Audit Review every Audit Partner is subject to quality assurance review by one of his peers annually and the designated audit compliance partner in each firm will sign off that this has been completed.

Small and sole practitioner firms have arrangements with other firms to carry out the annual review.

3. **Timescale and Fees**

JMU confirmed that for a review of a four/five partner firm they allow two days to conduct an Audit Review and estimated that a further one and half days would be required for Practice Review.

The cost of completing an Audit for a four/five partner firm was £750 per Inspector per day although to undertake Practice Review where all charges including overheads would be recovered, this was likely to be £900 per day per Inspector.

It was noted that the JMU employs Inspectors on a full time basis spread throughout the country, including two in Scotland.

The actual fees charged by the ICAEW for Audit Registration was based on a grading system. For a sole practitioner with one office it would be £260 per annum rising to £60,000 for large firms with a number of offices. This includes the fees for Inspectors as mentioned above but does not include any subsequent follow up that might be required if a transgression is uncovered. Such follow up visits would be fully charged on the basis of the Inspectors daily charge out rate.

4 **Confidentiality**

Inspectors working with the JMU are required to sign annual “fit and proper” certificates which require them to disclose any information, such as previous employment which might lead to conflict.

As far as engagement letters between firms and their clients, this was slightly academic for Audit Review and Investment Business Review as the JMU has statutory powers of intervention. It was agreed that this would be more problematic in Practice Review and firms would need to consider their terms of engagement.

5 **Risk of Litigation**

JMU recognised that the introduction of a quality stamp following Practice Review might lead to the risk of challenge. For example if JMU issues a quality stamp then a third party may seek to sue the Institute if things go badly wrong in respect of service given to that third party by the accredited firm.

6 **Reporting Breaches and Disclosure to Professional Body**

Accountants only report breaches to the Professional Body if it is in the public interest to do so, e.g. money laundering. Any minor breach of ethical guidance, for example would not be disclosed.

It was noted that Accountants working for Chartac Advisory Service were exempt from the Professional Ethics Code in respect of reporting breaches. Chartac is the body through which Advisory Services, on behalf of the ICAEW, is delivered to members and it sends Accountants into firms and in exchange for a fee advice is given to that firm.

7 Publicity

The meeting agreed this was vital. JMU on its Audit Regulation Committee and Investment Business Committee have at least three non-Accountants. The non-Accountants are required to report to the DTI on public interest matters. In addition, the Committee is obliged to report to the DTI on the audit side and meets with the FSA regarding investment business.

8 Soft Report

JMU highlighted a practice adopted by the Canadians in Alberta, whereby a “silent letter” or “soft report” is made available to the firm without further reporting. This was seen as an informal and effective way of improving standards.

Appendix D

UK Legal Profession - Compliance Monitoring

In section 4.4.2 of the report, reference is made to the Law Society of England & Wales having introduced Lexcel in spring 1998. Information obtained from the presidential meeting is set out in this appendix.

The core Practice Management Standards are the basis for the assessment. These standards were developed by the Law Society as a management tool to address the particular business needs of legal practices and have gained wide acceptance as an aid to efficient practice and improved client care. They form the basis for the Legal Aid Board's franchising specification and, therefore, have gained recognition as a credible quality standard.

The standards cover:

- management structure
- services and forward planning
- financial management
- managing people
- office administration
- case management

Lexcel provides a methodical and professional approach to management and administration which will reduce the risk of mistakes and wasted effort particularly in the areas of case work and communication with clients, where failings tend to lead to the largest volume of complaints and claims upon the solicitors indemnity fund (SIF). Failures in administration, not lack of legal knowledge, tend to lead to most claims on SIF.

Establishing the systems and procedures required by Lexcel will assist practices to ensure compliance with the professional conduct rules.

Assessment is carried out by certification bodies already accredited for the purpose of assessing ISO 9000 and by a number of Investors in People assessment units. Assessment includes a review of a sample of files.

By having the assessments carried out by third parties on behalf of the Law Society, it will ensure that the process is seen as objective and rigorously quality controlled. The standard itself will remain under the control of the Law Society.

Only assessors who have achieved certain qualifications, have experience of the legal sector and have undergone special training, will be approved by the Law Society to take part in this scheme.

Appropriate checks will be made on the Practices' SIF and disciplinary records before a certificate is awarded. After three years a full re-assessment is required.

The full costs are recharged to the practices involved.