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All you ever wanted to know about auditing but were afraid to ask

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Agenda

1. Trust and Public Perception
2. Audit Insights
3. Some Important Audit Concepts
4. The Actuarial Side to Audit





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Trust and public perception



Public Perception – Trusted People?



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<https://twitter.com/MallowNews/status/1019523917529190400>



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Public Perception – Trusted Brands?



M&S
EST. 1884



<https://bbonline.com/news/the-uks-most-trusted-brands-who-tops-the-pile/>
<https://www.opinium.co.uk/most-trusted-companies-in-uk/>

<https://www.campaignlive.co.uk/article/guardian-trusted-sun-least-trusted-online-news-brand-pamco-reveals/1492881>



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Public Perception – A Case Study (non-Actuarial)

- Volkswagen emission scandal in September 2015
- Severe loss of public trust and large share price crash
- Gained 40% since low point, but still down from peak



Volkswagen

Volkswagen Share Price



Emissions scandal

www.google.co.uk



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Audit Insights

Users of financial statements

Users	Purpose
Equity investors (report addressee)	Assess company's performance
Debt investors	Assessment of lending
Equity analysts	Base point for future prospects
Rating agencies	Informative for rating decisions
PRA and FCA	Informative for understanding financial performance (albeit not Solvency II capital)
HMRC	Starting point for corporation tax
Pension fund trustees	Assess strength of pension covenant
Employees	Share price performance
Trade unions	Employee prospects
Consumer organisations	Assess company stability to recommend to consumers
Financial press	Reporting news, scandals, investigations



Operating environment for audit firms

- Audits typically performed with unlimited liability.
- Tolerance for business failures post the Global Financial Crisis is low.
- Perception of huge rewards for directors in business and limited penalties for failure.
- Carillion and BHS two particularly high profile business failures subject to extensive scrutiny.
- Increased dialogue with both PRA and FCA – they expect a frank exchange of views from the auditors and regular meetings on bipartite and tripartite basis.
- Routine inspection of work internally and by the Financial Reporting Council.



Auditor responsibilities for statutory audit

Auditor's responsibilities

- Obtain reasonable assurance about whether the financial statements as a whole are
 - free from material misstatement, whether due to fraud, other irregularities (see below), or error, and;
 - to issue our opinion in an auditor's report.
- Reasonable assurance is a high level of assurance, but does not guarantee that an audit will always detect a material misstatement when it exists.
- Misstatements can arise from fraud, other irregularities or error.
- Consideration is given to the materiality (defined later).



Specialists in the audit

- Auditors need support across the audit, they can't do everything!
- It is a multi-disciplinary team
- Specialists may include
 - Actuarial
 - Tax
 - IRM
 - Valuations
 - Forensics



Enforcement cases against actuaries

	Case 1	Case 2	Case 3
Date	22 February 2017	22 February 2017	10 August 2017
Role	Former Chief Actuary	A former Actuary	Consulting actuary to Lloyd's syndicate
Fine	£101,500	£45,500	£75,200
Costs to be paid	£11,000	£3,500	£400,000
Regulatory impact	Ineligible for 3 years for a practising certificate	A Reprimand	A Severe Reprimand





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Some Important Audit Concepts

Key Terms and Definitions

- Materiality
 - Materiality, Performance Materiality, Audit Misstatement Posting Threshold (“AMPT”)
- Estimate
- Error
- Professional scepticism
- Disconfirming evidence
- Benchmarks



Materiality - concept

- The determination of materiality is a matter of professional judgement, and is affected by our perception of the financial information needs of users of the financial statements.
- Users:
 - a. have a **reasonable knowledge of business and economic activities and accounting**
 - b. understand that financial statements are prepared, presented and **audited to levels of materiality**
 - c. recognize the **uncertainties inherent** in the measurement of amounts
 - d. **make reasonable economic decisions** on the basis of the information



Changes in estimates versus errors

- Prior period errors are:
 - **Omissions from, and misstatements** in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:
 - (a) was available
 - (b) could **reasonably be expected to have been obtained and taken into account**
 - Such errors include the effects of **mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.**



Estimates vs Ranges

- There can be differences between two point estimates, two actuaries will probably take different views
- The actuarial audit team may calculate what they consider to be a reasonable range
- The audit considers whether the company's estimate falls within a reasonable range
- But what is reasonable?



Professional scepticism

- Auditors are required to exercise “professional scepticism”
 - This does not mean mistrust
 - But requires challenge and evidence rather than taking things on face value
- Professional scepticism is an attitude that includes a questioning mind
- When considering key judgements, higher levels of professional scepticism are applied in assessing the reasonableness – including consideration of historical reliability



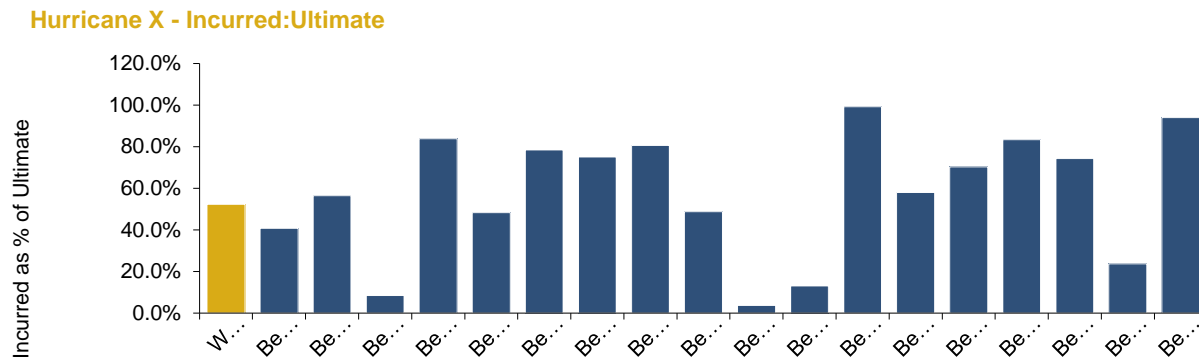
Disconfirming Evidence

- What is disconfirming evidence?
- How to handle two opposing conclusions for two different pieces of evidence?
 - What to choose or rely on? How to record this?
- Consider the impact
- Actuarial examples:
 - Anchoring bias
 - Loss ratios significantly better than industry peers
 - Inappropriate exclusion of outliers



Benchmarking

- Information from sources independent of the entity that may be used as audit evidence.
- Benchmarks are a guide only.
- Being in or out of the middle does not necessarily mean good or bad.
- Need to consider any potential anomalies that arise out of the benchmarking exercise.





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The Actuarial Side to Audit



Overview

- Auditing is not part of the actuarial exams.
- Yet reserving and accounting failure attract more attention than pricing failures.
- Actuaries must be part of the solution!



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Actuarial Audit Work

- Need to assist the auditors in forming a view on whether the accounts and judgements are reasonable
- Reasonable doesn't mean that everyone is the same:
 - For example, signing off on two insurers with Ogden assumptions of -0.75% and 0%.
- We have to build up the overall view taking perspective across the business.
- Use a range of tests include quantitative and qualitative.



Actuarial Audit Work (cont.)

- Governance, experience, competence
 - Consider review process for setting reserves, who signs off
- Data
 - Reconcile data to prior years etc, but critically liaise with audit team
- Process and methodology
 - Review methodology to calculate large loss IBNR and/or controls around the process
- Judgements and assumptions
 - Compare assumptions to results from data and market benchmarks, e.g. EL tail
- Alternative estimates
 - Conduct projections on material lines of business with greater uncertainty
- Further tests
 - Reserving diagnostics or RI 'netting down' to spot any unusual data features



Actuarial Audit Work (cont.)

- No test is considered in isolation
- But combined and in aggregate to develop a view
- Findings in one test may require further work in another
 - E.g. racy assumptions and poorly documented methodology may mean a greater number of independent projections to gain comfort (or not) over the reserves
- The following slides will cover a few typical tests in more detail and a few of the key areas we look out for...



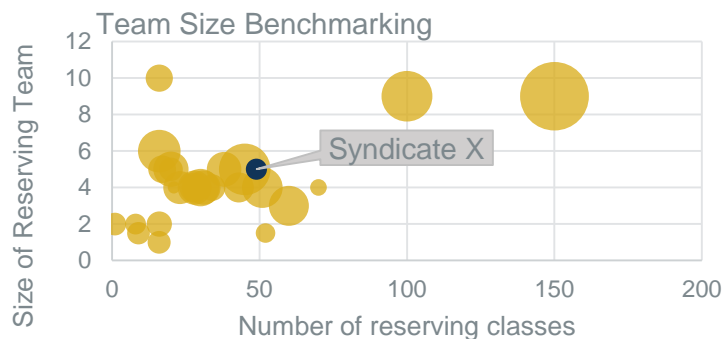
Group Task

- ... but first, a group task!
- Each group will have different information on parts of the accounts and/or actuarial work
- You should discuss in your groups whether the data indicates any risks or the level of prudence in the reserves
- Assign a rating of 1 – 5, and justify!
 - 1: Overly optimistic
 - 3: Best estimate
 - 5: Overly prudent
- In each case, consider what might the criteria be to not be acceptable? Of it not, what further evidence could be gathered?



Exercise 1 – Team

Team Member	Role	Experience
A	Chief Actuary	Has held the chief actuary role at the company for 15 years
B	Reserving Manager	5 years post qualification experience. New joiner, previously at a personal lines insurer
C	Reserving Manager	New qualified, joined 6 months ago but spent 4 years in a similar syndicate
D	Analyst	1 year experience
E	Analyst	New graduate



- A Lloyd's syndicate
- Stable and experienced senior management
- Managers with experience, but limited knowledge of the business
- Are there sufficient resources to carry out all the actuarial work to appropriate standards?
- Consider quantitative and qualitative



Exercise 2 – Methodology

- Ogden assumption for reserving was 1%
- Implied rate on settlement is decreasing following the Lord Chancellors announcement
- But consistently above 0%
- Is a trend forming?

- Summary of recent bodily injury claims settled

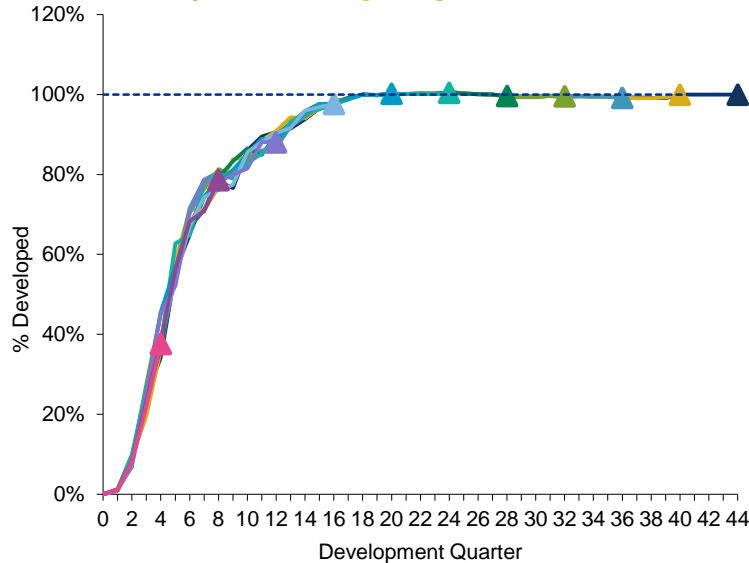
Date of settlement	Amount	Implied Ogden Rate
01/11/2016	£ 300,000	2.5%
14/12/2016	£ 150,000	2.1%
10/03/2017	£ 1,000,000	3.0%
21/07/2017	£ 1,300,000	1.7%
03/08/2017	£ 750,000	1.8%
19/10/2017	£ 100,000	1.5%
05/11/2017	£ 250,000	0.9%



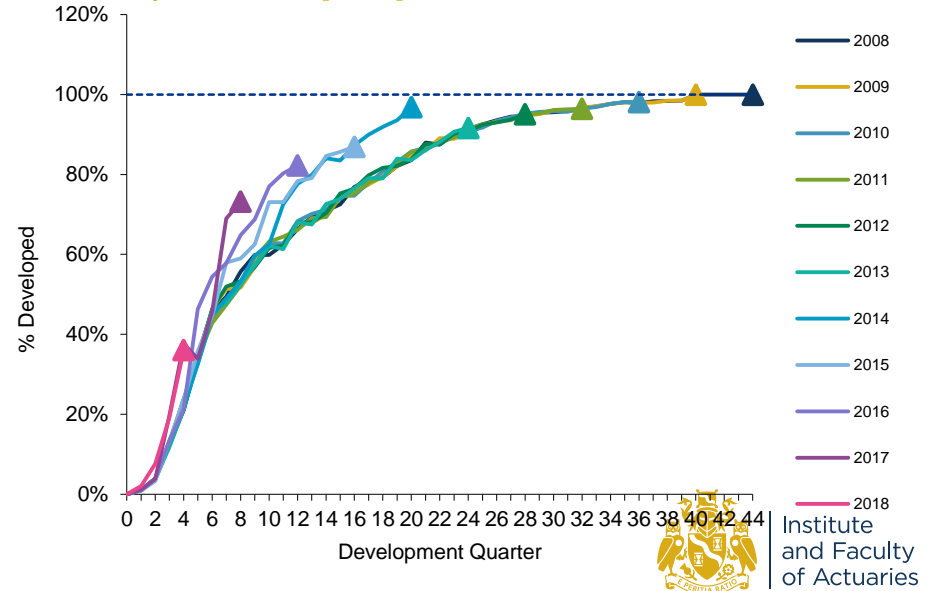
Exercise 3 – Diagnostics

- Selected projection methodology only considers the incurred
- Something has caused the paid to speed up. Should we be worried?

Incurred Development as % of [Client] Ultimate



Paid Development as % of [Client] Ultimate



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Exercise 4 – IELRs

- There is a consistent upward trend in IELRs over the initial development for each UWY
- Recent IELRs may be optimistic both the trend and $IELR < ULR$, resulting in under-reserving when using the BF method

Table 1a - IELR Pick Development as at 31/12/2018 - Employers Liability										
UWY	IELR selection at as at Date						Projection Method	ULR	% Development to Ultimate	
	YE13	YE14	YE15	YE16	YE17	YE18		YE18	Paid	Incurred
2013	50.0%	52.5%	54.1%	54.6%	54.6%	54.6%	Incurred CL	54.6%	50.2%	73.0%
2014		50.3%	52.8%	54.4%	54.9%	54.9%	Incurred CL	54.9%	45.3%	65.9%
2015			47.2%	49.6%	51.1%	51.6%	Incurred CL	51.6%	40.0%	56.6%
2016				50.3%	52.8%	54.4%	Incurred BF	60.2%	34.7%	50.5%
2017					49.1%	51.6%	Incurred BF	55.0%	17.1%	44.9%
2018						42.0%	Incurred BF	47.9%	10.5%	23.1%



Exercise 5 – Alternative Estimates

- Materiality £3m, total reserves £142m
- Overall, there is negligible difference
- But this is split looking CY vs PY
 - CY has a £9m deficit
 - PY has a £9m surplus
- This might be a case of optimistic business plans or IELRs
- What would be the impact on pricing or reserving for future years?
- What about the Solvency II impact?

UWY	Client Ultimate	Auditor's Ultimate	Surplus / (Deficit)*
2013	73	73	1
2014	74	72	2
2015	78	75	2
2016	79	79	0
2017	80	77	3
2018	89	98	(9)
2017 & Prior	773	724	9
Total	822	822	(0)

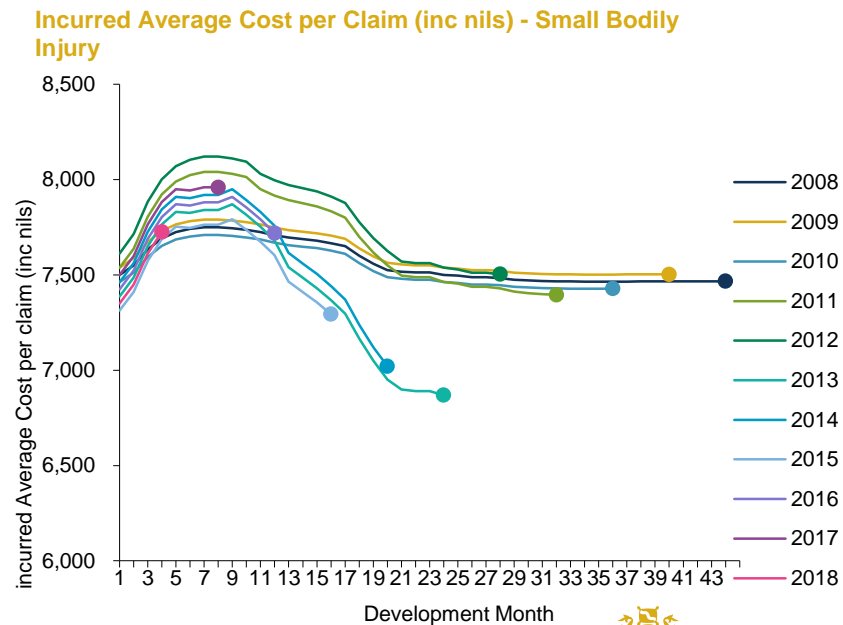
*small differences due to rounding



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Exercise 6 – More Diagnostics

- Personal motor severity for small bodily injury
- Marked change in the severity development from notification post April 2013
- Why? LASPO?
- Need to investigate if this has been allowed for in the projections



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Making the most of auditors

- Now you should have an insight into what the auditors do and are looking for
- How are they to be engaged?
 - Two way communication
 - Understand purpose of the work
- How can you help them?
 - Provide evidence to back up assumptions and processes
 - Propose changes in advance to get feedback on any remedial action required
- How can you get the greatest insight? How can they help you?
 - Benchmarking against peers
 - Supporting where there is pressure to reduce or increase selections
 - Extra level of challenge to check areas you should be thinking about
 - Help improve standards, c.f. upcoming IFoA peer review
 - Testing robustness before presenting to audit committee



Audit as an actuarial discipline

- Technical skills different to internal reserving
- TAS 200
- Learn different skills key to audit, those being: challenge, evidence based review, documentation
- Market understanding
- Board exposure
- A skill set applicable beyond audit



Questions

Comments

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