Audit is a mandatory cost...so get the most out of it

Robert Andrews, KPMG LLP
Agenda

• What do auditors actually do?

• What can I get out of it?
The speaker
Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged. The views expressed in this presentation are those of the presenter.
# Overview

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Why audit? (Some ideas)

- A legal requirement
- A mechanism which promotes trust in capital markets
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• A way for the board to keep an eye on management

• A standard against which management can measure itself
Why audit?
(Some ideas)

• A legal requirement

• A mechanism which promotes trust in capital markets

• A way for the board to keep an eye on management

• A standard against which management can measure itself

• A practical procedure which provides an independent outsiders view of the financial affairs of the business
What is an audit?

A reasoned opinion:

“… an examination, on a test basis, …”

“… significant estimates and judgements made by the directors …”

“… consistently applied …”

“sufficient evidence to give reasonable assurance”

“material misstatements”

“… true and fair view …”
The expectations gap

• Limited scope:
  • Test based opinion on financial statements
  • Financial reporting standards narrow scope

• User expectation outruns reality:
  • Genuine uncertainty
  • New facts cause revision to estimates
  • No opinion on future
Reality
Audit context – client taxonomy

Dangerous - “Finite reinsurance? Never heard of it”

Desperate - “Triumph of hope over experience”

Dazed or deluded – Unaware / misunderstand trends
Audit context – client taxonomy

Dangerous - “Finite reinsurance? Never heard of it”

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Dazed or deluded – Unaware / misunderstand trends

Most clients:
Decisive – Informed, consistent application of reserving policy

Deliberate – Informed, manage margins for convenience
# Audit context – stakeholders

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<th>Stakeholder</th>
<th>Deliverable</th>
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<td>- The board</td>
<td>Management letter</td>
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<td>- The audit committee</td>
<td>Audit memo</td>
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<td>- CFO, chief actuary</td>
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<tr>
<td>- The business</td>
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<tr>
<td>External stakeholders:</td>
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<tr>
<td>- Current shareholders</td>
<td>Audit opinion</td>
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<td>- Banks</td>
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<tr>
<td>- Potential investors</td>
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<td>- Counterparties</td>
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<td>- Regulators</td>
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<td>- Analysts rating agencies</td>
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Audit context – working papers

Requirement to document:
• Professional standards
• Legal protection

Working papers should evidence:
• Risk assessment
• Audit plan which addresses risks
• Testing carried out
• Results
• Basis of opinion
Audit context – role of actuarial support

Responsibility for opinion rests with audit partner:

• Actuarial support informs, audit forms own judgement on how much reliance to place
• Formally, role of actuarial support is analogous to any other specialist (for example, a chartered surveyor)

Actuarial wrinkle – Independent reserve review
• Legal reliance vs comfort
## Assurance methods

<table>
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<th>Testing approach</th>
<th>Example</th>
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<tr>
<td>Substantive</td>
<td>Re-projection of material classes</td>
</tr>
<tr>
<td>- Tests of detail</td>
<td>Investigate A v E using client model</td>
</tr>
<tr>
<td>- Analytical review</td>
<td></td>
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<tr>
<td>Controls based</td>
<td>Review of effectiveness of policies and procedures (eg a claims watchlist, peer review of projections)</td>
</tr>
<tr>
<td>- Design</td>
<td>Review evidence of control process in action (exception reports, evidence of peer review, meeting minutes)</td>
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<tr>
<td>- Implemented in practice</td>
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Assurance methods – systemic overview

For example:
- who is responsible for reserve setting?
- what information do they have to perform this role?
- how much time is available for them to ask questions?
- how much time is available to make decisions?
- are they appropriately experienced?

Overarching topic of reserving governance
Audit context – touchpoints

Formal report to board and audit committee

Feedback meetings – Auditor to CFO / chief actuary
Audit context – touchpoints

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Investigations
- Claims – large losses, trends, case reserve setting
- Underwriting – pricing trends, business mix, T&C’s
Audit context – touchpoints

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Clarification meetings – actuary to actuary

Other third parties – especially independent reserve reviews
What can the auditors do that I can’t?

Access to the business
- Access to audit committee / board
- Access to claims
- Access to underwriting
- Access to senior management
What can the auditors do that I can’t?

Compare market practice:
- Issue specific benchmarks
- Compare reserving techniques
- Compare processes
- Compare resources applied to reserving
What can the auditors say that can help me?

Comparison with market practice:
  Governance
  Processes
  Resources

Priority setting:
  Things that worry me
  “Tactical” information I would like to see
  ➢ Use the planning process well
The future

Now:
- We can agree to disagree
Future?
- My best estimate is better than yours (thanks to SII, IFRS4)

Potential issues:
How can management manage their reserve margins?
How can disagreements be resolved if these require adjustment?
What changes to the process are required?
Thankyou

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