

# Actuaries and Auditors

Apex Discussion Series

April 21, 2011

Paul Vendetti, FCAS, MAAA

# Actuaries and Auditors

## About the Speaker

Paul Vendetti is a senior consulting actuary in Pinnacle's Bloomington, IL office. Paul has over 15 years of experience as an Actuary and previously worked at Zurich and American Agricultural Insurance Company. At Pinnacle Paul currently works with a number of audit firms assisting in the review of held reserves and reinsurance risk transfer.



# About Pinnacle Actuarial Resources, Inc

---

- Total Staff of 53
- Including 18 credentialed actuaries
- Offices throughout the country
- Bloomington, IL, Chicago, New York (Long Island, Saratoga Springs), San Francisco, Indianapolis, Detroit, Columbus.
- Welcome Godbold & Malpere & Co to Pinnacle in Atlanta

# Outline of Presentation

---

- Professional Standards for Actuaries
- Roles of the Actuary in the audit
- Levels of Actuarial Review
- Risk Transfer

# Actuarial Standard of Practice (ASOP)

---

- The Actuarial Standards Board (ASB) promulgates the Actuarial Standards of Practice (ASOPs) and they are binding on all practicing actuaries.
- Relevant Actuarial Standards of Practice
  - No. 21 Responsibility to Auditors
  - No. 23 Data Quality
  - No. 36 Actuarial Opinions
  - No. 41 Actuarial Communications.

# Other Professional Guidance

---

- Data Testing Requirements (in Annual Statement Instructions)
- Practice Notes - Statements of Actuarial Opinion on Property and Casualty Loss Reserves

# Actuarial Standard of Practice 21

---

- *ASOP 21 – Responding to or Assisting Auditors or Examiners in Connection with Financial Statements for All Practice Areas*
- Defines the roles and responsibility of those involved in audit or examination, specifically;
  - “Responding Actuary” – actuary expressly designated by entity to respond to the auditor or examiner.
  - “Reviewing Actuary” – actuary expressly designated by the auditor or examiner to assist in the audit or examination.
- Both actuaries need to disclose their relationship if any with the entity
- Confidentiality – information received by the reviewing actuary should be considered confidential.

# Actuarial Standard of Practice 21

- Responsibilities of the Responding Actuary
  - Actuary should be appropriately responsive to the auditor's reasonable requests.
  - Responding Actuary should be prepared to answer questions regarding:
    - Data, Assumptions and Methods
      - Data and methods used
      - Source of Assumptions
    - Environmental Considerations
      - Change in operation
      - Trends in experience
      - Product and demographic mix changes
  - Request for information

# Actuarial Standard of Practice 21

- Responsibilities of the Reviewing Actuary
  - Actuary has responsibility with respect to the planning and documentation of the audit or examination procedures.
    - Planning
      - Scope of the audit
      - Nature, extent, and timing of the actuary's procedures
      - Communication
    - Documentation
      - In addition to requirements in ASOP 41 documentation should include:
        - Evidence that the reviewing actuary's procedures have been planned and coordinated with the auditor
        - Summary of items reviewed
        - Summary of results, providing conclusions and findings

# Actuarial Standard of Practice 23

---

- ASOP 23 – Data Quality
- Purpose is to give guidance on selecting, relying on, reviewing and using data
- “This standard does not require the actuary to audit data”
- Reliance on Data Supplied by Others
  - The accuracy and comprehensiveness of data supplied by others are the responsibility of those who supply the data.
  - Actuary should disclose such reliance in actuarial communication.
- The actuary should review data for reasonableness and consistency

# Actuarial Standard of Practice 23

---

- Limitation of the Actuary's Responsibility – The actuary is not required to do the following:
  - Determine whether data or other information supplied by others are falsified or intentionally misleading,
  - Develop additional data compilations solely for the purpose of searching for questionable or inconsistent data; or
  - Audit the data

# Actuarial Standard of Practice 36

- ASOP 36 – Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves
  - Applies to NAIC P&C Annual Statement Instructions
  - SAO prescribed by law or regulation
  - SAO represented by the actuary as being in compliance with ASOP 43.
- Defines the disclosures that need to be included in an actuarial opinion, including:
  - Scope of opinion
  - Materiality
  - Other disclosures

# Actuarial Standard of Practice 41

---

- ASOP 41 – Actuarial Communications
- Principles for oral, written or electronic communications
- Referenced in numerous other ASOPs
- Identify principal and scope of engagement
- Form and Content – should take appropriate steps to ensure communication is clear and appropriate to circumstances
- Use of communication by some one other than the principal
- “In the actuarial report, the actuary should state the actuarial findings, and identify the methods, procedures, assumptions, and data used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness”

# Actuarial Standard of Practice 43

---

- ASOP 43 – Property/Casualty Unpaid Claims Estimates
- Purpose – provide guidance to actuaries when performing professional services relating to estimation of loss and loss adjustment expense for unpaid claims for property/casualty coverages
- Describes many of the issues that need to be considered in producing an actuarial study, including:
  - “Intended measure”
  - Methods and model selection
  - Assumptions underlying the model
  - Data – refer to ASOP 23, Documentation – refer to ASOP 41
  - Uncertainty

# NAIC Requirements & Guidance

- Annual Statement Instructions for SAO – appointed actuary must state:
  - “I have reviewed the data for reasonableness and consistency”
  - “no data points outside the reasonable range I view as material”
  
- Reconcile to Schedule P
  
- Data Testing Requirements (Property and Casualty Practice Note, December 2010, Appendix 11)
  - Addresses the auditor review of data used by the Appointed Actuary.

# NAIC Requirements & Guidance

- Data Testing Requirements
  - Burden is on the Auditor to communicate with the Appointed Actuary regarding elements the Appointed Actuary identifies as being significant
  - Data identified as significant by the Appointed Actuary would not always have been tested as part of the audit. Separate testing may be required
  - Applied to claim loss and defense and cost containment expense
  - Applied to current calendar year activity

# NAIC Requirements & Guidance

- Data Elements Commonly Viewed as Significant
  - Premium
  - Claim Count
  - Salvage and Subrogation Recoveries
  - Exposure
  
- Data Organization
  - Direct/Ceded/Net
  - Accident Year/Report Year/ Underwriting Year
  - Statutory Line or coverage level

# NAIC Requirements & Guidance

- Data Testing - Other Issues
  - Not all data identified by the Appointed Actuary as significant will be tested. Testing is based on the auditor's assessment of materiality and other considerations.
  - The Appointed Actuary takes into account the level of reliance on the data in determining which data and attributes are significant
  - If the auditor's data testing reveals significant data discrepancies:
    - Management should advise the Appointed Actuary
    - Actuary revises estimates accordingly to determine if there is a material impact
    - If material, management is advised and a revised Opinion is issued

# Role of the Actuary in The Audit

---

- Opining Actuary
  - Independent Actuarial Review
  - Peer Review of Opining Actuary's report
  - Other professionals
- 
- Reserves are set “based on managements best estimate”

# Opining Actuary

- Signs the Statement of Actuarial Opinion (SAO) – Practice Notes, NAIC Instructions define the contents of the SAO
- Produces Actuarial Opinion Statement (AOS)
- Produces the actuarial report - ASOP's apply
- Types of Opinions
  - Reasonable
  - Inadequate – too low
  - Redundant – too high
  - No opinion – not enough information
  - Qualified – review a portion of the companies reserves
- SAO discusses loss and loss expense provision and unearned premium for long duration contracts

# Independent Actuarial Review

---

- Outside actuary provides a second review of the opening actuaries review. This is not a second SAO
- Selects actuarial methods to be applied and independently selects assumptions to be used in the projections; expected losses and loss development factors
- The second review typically includes a calculation of the required reserves and produces a report. This provides the audit firm with a level of comfort in the reserve opinion

# Peer Review

---

- Reviews the actuarial report to ensure the methods, assumptions and conclusions are reasonable
- Does not independently calculate reserves
- Reviews the methods and assumptions for adherence to professional standards

# Risk Transfer

---

- Accounting /Auditor decision
- Actuary can assist in quantifying whether there is evidence of risk transfer for a reinsurance contract
- Guided by SSAP 62 and FAS 113
  - Reinsurer assumes significant insurance risk
  - Reasonably possible that the reinsurer realizes a significant loss from the transaction
- See 2009 CAS Reinsurance Research Call Paper Program article entitled “Common Pitfalls and Practical Considerations in Risk Transfer Analysis.”

# Join us May 19

May 19  
ApexWebinar  
Register today!

## Credit Based Tools in Commercial Lines

Join Rob Walling and Experian as they examine both traditional and non-traditional tools used for rating and underwriting



## Thank You for Your Attention

---

Paul Vendetti, FCAS, MAAA

309.807.2312

[pvendetti@pinnacleactuararies.com](mailto:pvendetti@pinnacleactuararies.com)