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# *2014 Casualty Loss Reserve Seminar*

## Roll-forward reserve estimates
September 15, 2014

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# *Agenda*

# *Section 1 – Auditor's responsibilities*

## NAIC Property and Casualty Annual Statement Instructions

The auditor should:

- Subject the data used by the appointed actuary to testing procedures
- Determine what historical data and methods have been used by management in developing the loss reserve estimate and whether he or she will rely on the same data or other statistical data in evaluating the reasonableness of the loss reserve estimate
- Obtain an understanding of the controls related to the completeness, accuracy, and classification of loss data
- Obtain an understanding of the data identified by the appointed actuary as significant

# ***Section 1 – Auditor's responsibilities*** *(continued)*

## NAIC Property and Casualty Annual Statement Instructions (continued)

- Recognize that there will be instances when data identified by the appointed actuary as significant to his or her reserve projections would not otherwise have been tested as part of the audit, and separate testing would be required.

Unless otherwise agreed among the appointed actuary, management, and the auditor, the scope of the work performed by the auditor in testing the claims data in the course of the audit would be sufficient to determine whether the data tested is fairly stated in all material respects in relation to the statutory financial statements taken as a whole.

# *Section 2 – Testing loss and loss adjustment expense reserves*

**Audit considerations when planning the audit approach:**

- Type of company
- Lines of business
- Reinsurance program
- Results of risk assessment procedures and retrospective review of estimates
- Qualifications of the company's actuary
- Specialist actuary and timing of review
- Accuracy and completeness of loss development data

# *Section 3 – Audit approach*

## Audit strategy

| Assertion | Step | Procedure |
|---|---|---|
| **Completeness and Cut-Off** | 1 | Ensure actuarial data is consistent with claim data |
| **Existence/Occurrence and Rights & Obligations** | 2 | Test underlying claim data |
| **Valuation and Allocation** | 3 | Review reasonableness of management's estimate |
| **Presentation and Disclosure** | 4 | Ensure reasonableness of disclosures with audit testing performed |

# *Section 3 – Audit approach*

## Below are examples of typical audit procedures around Loss and LAE Reserves

### Completeness and Cut-Off

- Reconcile loss and loss adjustment expense payments* to the general ledger and appropriate subsidiary ledger and statistical records
- Selecting loss and loss adjustment expense payments* to determine if the claim has been reported in the correct period

### Existence or Occurrence and Obligations

- Inspect the underlying documentation of selected loss and loss adjustment expense payments* supporting relevant accounting and statistical data, such as amounts, incurred dates, coding line of business, etc. (claim file testing)

*Payment may relate to open or closed claims

# *Section 3 – Audit approach* *(continued)*

**Valuation or Allocation**

- Gain an understanding of the company's method of determining the reserves and evaluate its reasonableness
- Evaluate the reasonableness of carried reserve compared to the reasonableness of the range
- Determine if there have been any significant changes in the company's methods and procedures, and evaluate the effect of all current trends and conditions
- Review current reports of state insurance examiners and loss developments prepared for the annual statements and Schedule P, and investigate significant items

# *Section 3 – Audit approach (continued)*

**Presentation and Disclosure**

- Validate the loss and loss adjustment expense reserve disclosures to the audit testing performed

**Coordinate audit approach with Actuary**

- Test reliability of data determined to be significant by the actuary
- Confirming the independence, competence and objectivity of third-party external actuaries and obtain Statement of Actuarial Opinion

# *Section 4 – Roll-forward procedures*

**Testing of remaining period involves performing substantive procedures, or substantive procedures combined with tests of controls, that provide a reasonable basis for extending the audit conclusions from the interim date to the period-end**

Procedures should include:

a. Comparing relevant information about the account balance at the interim date with comparable information at the end of the period to identify amounts that appear unusual and investigating such amounts.

b. Performing audit procedures to test the remaining period.

# ***Section 4 – Roll-forward procedures*** *(continued)*

**The nature and extent of roll-forward testing depends on:**

- The risk associated with the account
- The length of the roll-forward period
- Account turn-over during the period
- Reliance on controls (information technology and business process)
- The rigor and precision of other procedures
- Other factors

## *Section 4 – Roll-forward procedures*

Timing of testing

| | | |
|---|---|---|
| **Completeness and Cut-Off** | 1 | Ensure actuarial data is consistent with claim data |
| **Existence/Occurrence and Rights & Obligations** | 2 | Test underlying claim data |

Steps 1 and 2 can be performed prior to year-end

- How early is too early to cut-off claim data testing?
- Factors to consider include prior year experience, control environment, system/personnel changes
- Roll-forward procedures may include detailed testing of claim data, substantive analytics or combination of both.

# *Section 4 – Roll-forward procedures*
## Substantive analytics

**To develop an effective expectation when performing a substantive analytical procedure requires:**

- Using industry averages when available and relevant
- Computing certain relationships and ratios
- Understanding the business mix
- Understanding changes in:
  - Premium rates
  - Retention levels
  - Reinsurance programs
  - Claims handing and settlement practices

Types of substantive analytics include trend analysis, ratio analysis, reasonableness tests.

# Section 5 – Subsequent events

Subsequent events are those events, both favorable and unfavorable, that occur after the date of the financial statements (referred to as the "balance sheet date") and prior to the issuance of the financial statements (and management's report on the assessment on the effectiveness of the company's internal control over financial reporting, if applicable).

Two key determinants:

1. The type of subsequent event.
2. Whether the event occurred before or after the financial statements have been issued.

# *Section 5 – Subsequent events* *(continued)*

## Type 1

- Provide additional evidence with respect to conditions that existed at period-end (the balance sheet date).
- Information should be used by management in its evaluation of account balances.
- The financial statements should be adjusted for the effects of such events.

## Type 2

- Provide evidence with respect to conditions that **did not exist** at period-end (the balance sheet date) but arose subsequent to that date.
- Generally, the financial statements are not adjusted for these events but additional disclosures in the financial statements must be considered.

# *Questions?*

# Thank you