





Three Perspectives on Peer Review

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Learning objectives



- Testing of actuarial reports - Audit Risk
- Requirement of auditor's under GAAS
- Testing of key data, and testing key areas of the actuary's report
- Review of actuarial methodologies



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Auditor Goals, Approach and Focus



- The Goal: comfort over management's booked loss reserves
- The Approach: test the work of management's specialist
- The Focus: IBNR reserves (GAAS Audits)



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Significant Estimate

- Loss reserves (IBNR) = significant estimate
- Usually material to the Financial Statements
- High degree of uncertainty, judgment required
 - Must consider competency, internal/external factors
- Susceptible to bias and manipulation
- Generally, few internal controls over IBNR estimation



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Discussion

- Have you ever felt pressured by Management on the loss reserving process?



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Why we need to do this—audit standards





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What we need to do—the standard (GAAS)

AU-C 500 paragraph .08:



- a. evaluate the competence, capabilities, and objectivity of that specialist;
- b. obtain an understanding of the work of that specialist; and
- c. evaluate the appropriateness of that specialist's work as audit evidence for the relevant assertion.

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Evaluating an actuary

- What would concern you?
- Who should evaluate?
- What should the criteria be?

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What we need to do—Evaluate the specialist





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Obtain an understanding—scope actuary's work



- What's the scope?
 - Included, excluded?
- What's changed since last year?
- Is the actuary's understanding of the business, exposures and coverages accurate?
- Something missing, things not adding up?
- Document understanding and inquiries

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Obtain an understanding—actuary's data



- Which data does the actuary consider critical/significant
- NAIC filers: significant data letter required
- We are required to test data we deem significant to the estimate we are auditing
 - If our thoughts differ from actuaries, inquire:
 - Why included? How did they use?
 - Document if we still do not consider something significant
- Document critical/significant data, how we tested the data

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Evaluate the work—loss data, overview



- Agree actuary's loss data (paid and case reserves) to management's loss data
 - Must ensure actuary's data relates to underlying source data
- Something missing, things not adding up?

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Evaluate the work—loss data, specifics



- Example testing approach
- Tie-out each line of business in total
 - Paid and case reserves
 - Tie-out data in aggregate
- Select sample lines of business and sample years
 - Tie-out data in total by year for each line selected
 - This step tests accuracy of loss data allocation



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Evaluate the work—loss data, specifics



- Variances—if the data does not tie exactly
- Judgment required, must understand:
 - Causes of variances
 - Impact on reserve estimates/booked reserves
- Materiality applies to the booked reserves
 - Consider impact of variances on overall reserve estimate, booked reserves



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Evaluate the work—exposure data, overview



- Consider impact of exposure data on selected methodologies
 - Examples: bed/auto/employee counts, payroll, earned premium
- Actuary must identify “significant data” for NAIC filers
 - “Significant data” may not have significant impact on reserve estimate
- Possible approaches to testing exposure data:
 - Analytical: compare to prior years, changes in business/program, use information obtained from underwriting testing as basis for analytic
 - Tie-out: agree to exposure data provided by management/client
 - Inquiry: ask about changes, need to understand impact on total reserves
 - Level of testing will depend on significance of the exposure item to estimate



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Evaluate the work—loss data, understand potential pitfalls

- Valuation date may not be client year-end
- May limit loss data
- Multiple claims may be combined as one loss event
- May sort/disaggregate loss data differently than management
- Certain exposures, years, insureds etc. may be carved out
- We need to understand why actuary manipulates data and evaluate the appropriateness, may re-perform on a sample basis



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Evaluate the work—analysis, overview

Auditors are not actuaries, our responsibility is to:

- obtain an understanding of the work of that specialist; and
- evaluate the appropriateness of that specialist's work as audit evidence for the relevant assertion.



We must document our analysis and conclusions:

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Evaluate the work—analysis, overview




- Review actuary's description of business and program
- Review actuary's understanding of policy terms and limits etc.
- Review actuary's scope of work
- Something missing, things don't add up?

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Evaluate the work—analysis, lines of coverage



- The goal: gain comfort over booked loss reserves (IBNR)
- Consider lines where the bulk of IBNR resides
- Consider significant lines for ASU 2015-09 disclosures
 - >10% total gross reserves, by line
 - ≥75% total gross reserves, in aggregate



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Evaluate the work—analysis, methodologies



- Review schedule of selected ultimates
- Which methodologies drive total IBNR estimate?
 - Select methodologies that most closely approximate IBNR estimate on the selected lines



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Evaluate the work—analysis, years



- Select year(s) for more detailed testing:
- Follow data through actuary's schedules
 - Understand how critical computations and assumptions impact IBNR
- Ask about older years with large IBNR, change in IBNR



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Evaluate the work—inquiries



- Inquiry is essential component of testing
- Understand and evaluate the appropriateness:
 - Loss & exposure data, industry data, methodologies & assumptions
 - Changes in actuary's approach/analysis etc.
 - Unusual loss developments/trends
- [Required inquiry]: undue pressure from management



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Evaluate the work—inquiries

- Variances, potential errors?
- Errors confirmed
 - Will this change the actuary's analysis or recommendations?
- Don't wait!





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Evaluate the work—methodologies, overview

We must understand and evaluate the appropriateness of methodologies used by the actuary, consider:



- Are these commonly used methodologies?
- Does the application seem reasonable?
- Do the inputs (exposure data, industry data) appear reasonable?
- Do the results appear reasonable given what we've noted in the underlying loss data or exposure data?




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Other topics—industry data, benchmarks

- Ask actuary about use of industry data and benchmarks:
 - Why, and to what extent (where in the analysis)?
 - What are the sources of the data?
 - Any changes from the prior year/analysis?

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Questions?

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