

Session 32

Managing the Auditor/Client Relationship

October 15, 2007

Agenda

- Why is this important?
- Auditing Accountant Perspective
 - Kathy-Ann Edwards, PwC
- Company Actuary Perspective
 - Rod Bubke, Ameriprise Financial
- Auditing Actuary Perspective
 - Jason Morton, Deloitte

What's Changed?

- Sarbanes – Oxley
- Only 4 auditing firms
- Auditing firms get audited themselves
- Actuarial results are an area of focus due to subjectivity

Definition of an External Auditor

- An external auditor is an audit professional who performs an audit on the financial statements of a company, government, individual, or any other legal entity or organization, and who is independent of the entity being audited. Users of these entity's financial information, such as investors, government agencies, and the general public, rely on the external auditor to present and unbiased and independent evaluation on such entities. They are distinguished from internal auditors for two main reasons: (1) the internal auditor's primary responsibility is appraising an entity's risk management strategy and practices, management (including IT) control framework and governance processes, and (2) they do not express an opinion on the entity's financial statements. — Wikipedia

What Is the Role of an External Auditor?

- Engaged by the audit committee/senior management to express an opinion on whether an entity's financial statements are free of material misstatements.
- Normally, external auditors review the entity's information technology control procedures when assessing its overall internal controls.
- External auditors must also investigate any material issues raised by inquiries from professional or regulatory authorities, such as the local taxing authority.
- For public companies, the Sarbanes-Oxley Act (SOX) has imposed stringent requirements on external auditors in their evaluation of internal controls and financial reporting.

How is the external auditor able to express an opinion?

- Perform an in-depth planning exercise that allows the auditor to identify audit risk relating to financial reporting.
 - Meeting with management and the business areas to understand significant business issues.
- Once the audit risks are identified, develop an audit strategy.
 - Entails developing a plan on what's going to be tested and how. Decide whether tests of details or controls will be performed.

How is the external auditor able to express an opinion? (cont'd)

- Example of what this mean's to us here, the auditor plan will focus on financial statements for actuarial developed balances, this will include:
 - Meeting with key management personnel to obtain an understanding of the business, products, methods, assumptions, controls etc.
 - Based on this understanding, determine the test approach – Sample of products, controls testing around products, key calculations etc.

How is the external auditor able to express an opinion? (cont'd)

- In summary to be able to express an opinion, the auditor has to plan, perform and document the audit in compliance with all applicable professional standards, including those issued by the PCAOB.
- Also where applicable, the plan should cover if opinions need to be issued on various bases of accounting – e.g. US GAAP, Statutory, IFRS.

Key Factors in maximizing the Auditor/Actuary Relationship

- Upfront communication
 - Early discussion on issues, significant judgments and changes.
Examples:
 - Client actuarial team has a plan to change the a reserving methodology for a product. How does that impact the financial statements?
 - Client actuarial team is in the middle of a mortality study and the third quarter 10Q is about to be filed, what should happen?
 - Understanding of what are the audit risk.

Key Factors in maximizing the Auditor/Actuary Relationship

- Explaining how the planned procedures will help or link to the Financial Statement audit.
- Discussing how the controls testing fits into the overall picture.
- Clear discussion on timelines
- Explaining the testing approach – what does it mean by the auditor performing detail audit procedures?

Key Factors in maximizing the Auditor/Actuary Relationship

- Discussion on Fraud – explanation on why that's important and what does it mean.
- Coordinated perspective and view point from the auditor and the actuarial specialist on the audit team.

Company Actuary Perspective

- Why is a good relationship important?
- Traits of a Good Relationship
- What is expected of us?
- What can / should we expect from auditors?
- Communication

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Importance of a Good Relationship

- Enhance the financial reporting process
 - New issues can be dealt with collaboratively
 - Reduces “Surprises”
 - Reduce the likelihood of control deficiencies
- Work more as a team, not us vs. them
- Make everybody's life easier

Traits of a Good Relationship

- Collaborative vs. Adversarial
- Open and regular communication
- Congenial Attitude

What is Expected of Company Actuaries?

- Provide requested data in a timely manner
- Provide information in reasonable formats
- Adequate Documentation
- Communicate
 - Timing issues
 - Response to open items
 - SOX walk throughs

What Can Company Actuaries Expect?

- Auditor communicates internally concerning the client
 - Year over year
 - Within audit cycle
- Timely feedback
- Consideration of conflicting priorities
 - Resource contention for competing projects
- Industry information
 - General trends in the industry?
 - What are companies considering relative to an issue

What Can Company Actuaries Expect? (cont)

- Communication
 - What is needed?
 - When is it needed?
 - Why is it needed?
 - Specific request

Auditing Actuary Perspective

- Understanding the Audit Process
 - Scope, Timing
 - Summary of Major Worksteps
- Interactions between actuaries and accountants
- Communication
 - Expectations
 - Documentation

Understanding the Audit Process

“Why are these people bothering me at my busiest time of year?”

- Consequences
- Scope
- Timing
- Summary of audit actuary worksteps

Consequences

- Audit opinion delayed, withheld, or 'qualified'
- "Significant Deficiency" or "Material Weakness"
- Management letter comments
- Summary of adjustments passed

Scope

- More time and attention on actuarial balances, processes, issues
- Certain items are out of scope of audit review
- Theme: perform more review earlier in the year
 - On 9/30 balances, also some on 6/30

Timing

Major phases

- Planning
- Requests
- Work, interaction, issue resolution
- Close

Audit Actuary Worksteps

- Follow-up from prior periods
- Changes (systems, bases, approaches)
- Movements – trend analysis
- Reasonableness – analytic review
- Accuracy – mechanical testing
- Controls review
- Tracing and reconciliations

Interactions Between Actuaries and Accountants

- Three major steps of valuation
 - Data (extracts, other inputs)
 - Computations (calculation engine)
 - Reporting (incl. consolidation to ledger)
- All steps are important, but hand-offs are critical
- Old days: actuaries dealt only with computations. Not as silo'd now

Interactions Between Actuaries and Accountants

- Main contact point for company actuary may be auditor's accountant, not actuary
 - On-site more often
 - Auditor accountants and auditor actuaries use much of the same information
 - Be patient with the accountants – you won't always be able to deal just with actuaries
 - Best in class companies have close working relationships between their actuaries and accountants

Interactions Between Actuaries and Accountants

- Actuaries are lower on the hierarchy with respect to financial reporting rules
- Specific accounting issues
 - Error vs. refinement treatment
 - A “better answer” should be booked
 - No spreading of impacts
 - Q1 vs year-end overlap

Communication

- Expectations
- Interests are aligned
- Two-way communication
- Year-round audit
- Documentation

Documentation

- Support for reported balances
- Company provides information, auditor audits
- Auditor has stringent documentation requirements

A good rule to follow:

If documentation doesn't exist, the task was never performed