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Enhancing Controls in Conjunction With GAAP LDTI

By Mark Spong and Katie Kervick

As a congressional page, one of the authors witnessed the passage of the Sarbanes-Oxley Act (SOX) of 2002. The legislation—officially called the Corporate and Auditing Accountability, Responsibility, and Transparency Act—was unexciting compared to higher profile legislation like the Patriot Act. This is a reminder of how easy it is for all of us to underappreciate financial controls; we hate to think controls will be an afterthought again as the industry implements the Financial Accounting Standards Board's (FASB's) long-duration targeted improvements (LDTI).

This article reviews why financial reporting controls are relevant to actuaries. It also discusses the impact of LDTI on controls and the strategic decisions that insurers need to make.

WHY ARE FINANCIAL REPORTING CONTROLS RELEVANT TO ACTUARIES?

SOX put a spotlight on financial reporting controls nearly two decades ago. However, control deficiencies and material weaknesses remain numerous and prominent. According to the Audit Analytics publication, 2018 is looking to be the worst year for the insurance industry in recent history. Figure 1 shows that control weaknesses through eight months of 2018 were high relative to prior years.

Financial consequences of control failures are significant: financial penalties, erosion of consumer trust, loss in shareholder confidence and meaningful costs related to remediation. Control failures can also shift focus away from the execution of strategic priorities, harm morale and trigger employee turnover. Although material weaknesses are often triggered by errors and restatements in financials, an error is not a necessary condition. Material weaknesses originate from deficiencies in the control environment, regardless of the presence of a control failure.

Further, we observed an increase in the scrutiny applied by accounting firms to life insurers in response to oversight from the Public Company Accounting Oversight Board (PCAOB).

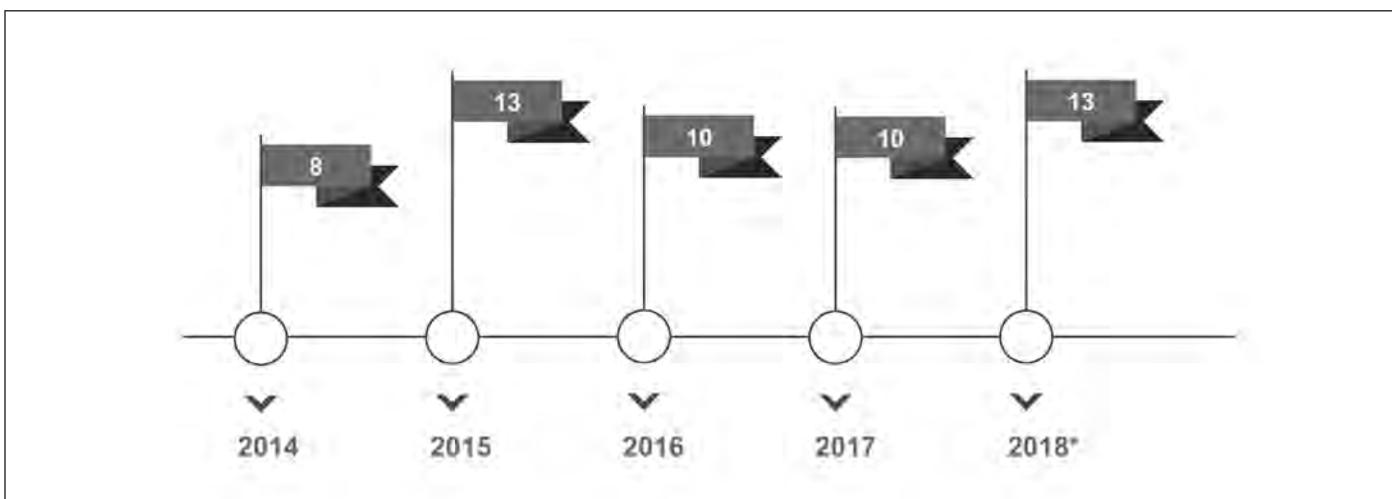
This, as well as profound upcoming accounting changes, in particular FASB's LDTI, requires actuaries to be alert to and mindful of their contribution to financial reporting controls.

WHAT IS THE IMPACT OF LDTI ON CONTROLS?

LDTI greatly impacts all significant financial reporting control areas relevant for life actuaries, especially data, assumptions, models and post-modeling processes.

- **Data:** The data used will need to be more granular for cohorting, attribution analyses and disclosures. New controls may be needed on new or upgraded data feeds.

Figure 1
Control Weaknesses Among Registered Insurance Participants



* 2018 results based on first eight months only.

- **Assumptions:** Traditional and limited-pay business will now use assumptions that are current best estimates as opposed to locked in at issue. Controls surrounding experience studies and assumption review processes for impacted product lines may need to be developed or enhanced.

- **Models:** There will be significant changes to calculation logic and a shift to adopt model-based liabilities for traditional business. There will also be auditable disclosures that require additional setup, testing and infrastructure. Controls supporting the production of eight quarters of auditable financial statements will need both oversight changes and operational enhancements.

- **Post-modeling processes:** The derivation of actuarial balances will be significantly changed, and auditable disclosures will need to flow to financial statements. Control activities for initial setup and ongoing monitoring need to be developed and maintained.

WHAT STRATEGIC DECISIONS SHOULD INSURERS MAKE RELATED TO CONTROLS AND LDTI?

For each new requirement under LDTI, insurers will need to decide whether to opt for "smart compliance" or pursue process improvements such as consolidation and automation. Process improvements are ideal because they will lower the number of resources needed to produce financials and execute controls after the transition. For example, due to the new and more granular data inputs required under LDTI, it may be a good time to create a "single source of truth" data lake or data warehouse. Otherwise, insurers may need to develop stopgap controls on the new input data sources and spend time reconciling multiple sources of data during the LDTI implementation.

However, even with an extended timeline for LDTI (the FASB is considering a one year extension to Jan. 1, 2022, for public companies), there will not be time to make all the desired process improvements, and insurers will need to prioritize. The goal will be to find a degree of process improvement that is attainable within the LDTI timeline and reduces resources needed for the new financial reporting process as much as possible. Decreasing the resources needed for financial reporting will allow the remaining resources to continue making process improvements and to execute stopgap controls until remaining process improvements are complete.

Examples of opportunities to minimize the resources required for financial reporting and controls are summarized in Figure 2. Insurers should review their existing processes to understand the

Figure 2
Process Improvement Opportunities

Category	Examples of Opportunities
Data	Create a "single source of truth" data lake or data warehouse Empower a data steward or chief data officer with the right mandate and responsibilities
Assumptions	Streamline experience studies Deploy oversight with transparent thresholds for risk and materiality Implement a scalable assumption repository for tracking approval status and application
Financial reporting models	Convert or retire legacy systems Leverage out-of-the-box vendor functionality where possible Maintain strict version and access controls
Upstream and downstream tools	Reduce the use of upstream and downstream tools and automate the remainder
Process and staff utilization	Streamline controls and review procedures by partnering with auditors Optimize use of actuaries across process design, production, analysis and controls

range of opportunities and prioritize what can be implemented prior to the LDTI transition.

CONCLUSION

Actuarial controls are increasingly relevant when accounting guidance changes. Thoughtful design of the new financial reporting processes and controls is needed to create sustainable financial reporting post-LDTI. Insurers that invest more resources in the design phase now will need fewer resources to execute the financial reporting and controls after transition. ■

Mark Spong, FSA, CERA, MAAA, is a senior consultant at Oliver Wyman. He can be reached at *mark.spong@oliverwyman.com.*

Katie Kervick, FSA, CERA, MAAA, is a consultant at Oliver Wyman. She can be reached at *katie.kervick@oliverwyman.com.*