



10 September 2021

Feedback on the actuarial aspects of insurance entity audits

Dear Sir/Madam

In performing audits for insurers, actuarial specialists or experts are routinely utilised to advise audit engagement leaders (“auditors”) on actuarial matters in relation to the audit of the financial statements¹. Based on recent experience from conducting Audit Quality Review (“AQR”) inspections across various audit firms, I am writing to set out a number of areas where further attention may be needed. I encourage you to share and discuss the contents of this letter with your actuarial specialists and experts, to identify any areas of improvement that may be needed.

Data

Where the actuarial specialists and experts at the audit firm have been asked to reproject the audited entity’s data, the responsibility for checking the accuracy of this data is often split between the core audit team and the actuarial specialists and experts. In some cases, we have observed that this division of responsibility has not been set out clearly in the scoping documentation. To ensure there are no gaps in the coverage of the data testing, we encourage audit teams to clearly set out the responsibility for checking the various data sets.

In the situation that the core audit team is responsible for all data testing, we still consider it important that the actuarial specialists and experts check the data is appropriate for the modelling exercise in question, as per provision 2 of Technical Actuarial Standard (“TAS”) 100.

Judgement and Assumptions

It is critical that the actuarial specialists and experts provide the auditor with sufficient information to enable the auditor to understand the key assumptions and the key areas of judgement used within the actuarial advice. In our inspections, we have observed cases where these are not clearly documented on the audit file, which makes it unclear whether the auditor has all the key information available when the audit opinion is formed.

Modelling

Modelling is a key tool used in the valuation of the assets and the liabilities of an insurer, and is therefore a key aspect of an audit for an insurer. We encourage audit teams to be alert to the following:

- i. **Reviewing models** – The establishment of technical provisions by the audited entity is dependent on appropriate and reliable actuarial models. As well as the assumptions being appropriate, it is important that these models used by the audited entity function as intended. To ensure these models are fit for purpose, we encourage audit teams to consider how regularly such models should be reviewed without reliance on previous assessments,

¹ See Practice Note 20 (Revised 2017) *The audit of insurers in the United Kingdom*, paragraphs 164-188. This sets out relevant considerations for the auditor when working with actuarial specialists and/or experts, including the application of ISA (UK) 620 (Revised 2019) *Using the work of an auditor’s expert*.

and to document this within the audit file. Without this, there is an increased risk of model error over time.

ii. **Use of benchmarking** – We have observed audit firms using benchmarking to assist with forming an opinion on the appropriateness of the assumptions used by the audited entity. For the benchmarking to be effective, the benchmarks need to be appropriate for the use they are being put to. We encourage audit teams to document why they consider the benchmarks used are appropriate when benchmarking is being used. This is particularly important if they are being used in areas where the experience is unprecedented such as the Covid 19 pandemic.

Where the actuarial specialists or experts have been asked to reproject the audited entity's data using their own models, we encourage audit teams to be alert to the following:

i. **Limitations of models** – Most models are imperfect descriptions of reality and are expected to contain limitations. Whilst these limitations do not necessarily preclude the use of the model, such limitations, and their materiality, need to be clearly communicated to the auditor with the results.

ii. **Availability of the models used in audits for AQR inspection** – Where audit teams created models which are relied upon to form significant judgements as part of their audit, sufficient detailed explanation of these models (including the assumptions and judgements used in the implementation of the model) should be made available to the AQR inspection team to allow the AQR inspection team to assess whether the work performed is sufficient and appropriate to enable the auditor to form an opinion on the valuation. This, in most cases, would be most straightforward by making these models used by the audit teams available to the AQR inspection team.

iii. **Use of in-house software** – Audit firms may choose to use in-house software rather than off-the-shelf software to perform some of the tasks within the audit. Where the auditors and/or actuarial specialists have relied on in-house software, it is important that the audit firm is able to demonstrate how they have gained comfort that the software is operating as intended.

If you would like to discuss the contents of this letter, please contact your usual supervisory contact at the FRC.

Yours faithfully

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