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Dear BAS Director

Actuarial Information Used for Accounts and other Financial Documents: Consultation Paper - Ernst & Young LLP response

INTRODUCTION

1. Ernst & Young LLP welcomes the opportunity to comment on BAS's draft paper *Actuarial Information used for Accounts and other Financial Documents: Consultation Paper* ("the Consultation Paper").

2. The primary purpose of the proposed TAS is to enable actuarial information used in the preparation of financial documents to be as supportive as reasonably possible for those who use the information. The Consultation Paper outlines the core principles of this TAS, including its rationale and requirements of actuaries. It does not revisit matters covered in the Generic TASs.

3. Unless the context dictates otherwise, defined terms in this letter have the same meaning given to them in the Consultation Paper.

OUR INTEREST

4. As the BAS will be aware, Ernst & Young is one of the largest global professional services organisations. We provide a wide range of audit, accounting, tax, corporate finance and other business advisory services. All of our UK activities are supervised by the Institute of Chartered Accountants in England & Wales, with further supervision over certain parts of our business by the Financial Reporting Council ("FRC"), the Financial Services Authority ("FSA") and other regulators. Our interest in this Consultation Paper is threefold:
   - There are over 150 members of the actuarial profession (including both actuaries and trainees) working in our UK firm in the fields of life insurance, general insurance and pensions.
   - We have extensive dealings with actuaries in relation to insurance and pensions matters, in our work as auditors and in a whole range of advisory services. Increasingly, actuarial matters are more and more critical to our opinions.

- As a large business supplying actuarial analysis and advice to our clients, Ernst & Young LLP is itself a user of actuarial information in insurance.

5. We continue to recognise the important role that the FRC and BAS play, to help improve corporate governance in general and the quality of financial reporting in particular. Both contribute to the maintenance and improvement of confidence in the capital markets, at a time when the need for this has never been greater. For this reason we fully support the aims of the FRC and the work of BAS.

MAIN OBSERVATIONS

6. We have three main observations.

7. First, audit-related work (where advice is provided within the audit firm) should be removed from the scope of the Accounts TAS. Actuaries working on an audit have no third-party engagement but are instead members of the audit team. As such, their audit-related work must meet the requirements set out by the audit team, in accordance with professional auditing standards. In such cases the actuary is acting more as an auditor.

8. Second, accounting for pension costs is excluded from the Pensions TAS. This TAS is directed at Reserved Work where its users will be pension scheme trustees and regulators. Accordingly, a separate Accounts TAS makes sense for work which is not necessarily Reserved Work; where its users include company directors and readers of accounts.

9. However, at the time of writing, it appears that there is a significant overlap between the Insurance TAS and the Accounts TAS. This suggests that insurance could be removed from the Accounts TAS. If insurance is removed, then this document will need to be renamed or, if necessary, form part of the Pensions TAS.

10. From an insurance perspective it is unclear whether the principles of the Accounts TAS are aimed at addressing measurement or disclosure objectives, or both. For example, para 4.38 states that actuarial work in connection with reinsurance to close premium should be excluded from the Accounts TAS and instead included in the Insurance TAS. It is not clear why this particular item has been singled out, unless it is because measurement calculations are to be excluded.

GENERAL OBSERVATIONS

11. There are general observations we wish to make below. These highlight some of our views prompted by your questions, and other remarks which fall outside the scope of these questions.

12. *TAS overlap*

    It is important to understand the overlap between the Insurance, Pensions and Accounts TASs. This will help to determine the potential value of introducing an Accounts TAS, and indicate future requirements to promote consistency between all three. However, our comments on the current proposal for an Accounts TAS have to be made in the absence of the other two TASs, which obviously requires us to make various assumptions when responding to your questions in the Consultation Paper.

13. *TAS lead time*

The date of introduction of any Accounts TAS needs to allow sufficient time for actuaries, and the users of their output, to adjust their processes and approach as appropriate. We believe this will require a timeframe of at least one year for all concerned, following publication of the final exposure draft.

14. *International context and competition*

It is important to avoid placing members of the Institute and Faculty at a competitive disadvantage. This could happen if future TASs require additional and/or inflexible work requirements which are not essential (or may become unnecessary) for end users and/or actuaries. For example, in regards to Solvency II and IFRS, we consider it particularly important that existing and future requirements for actuarial work in the UK do not become more onerous compared with other EU countries. If this is overlooked, the competitiveness of the UK's insurance market could be damaged as users seek comparatively cheaper advice from non-actuaries, or actuaries based overseas.

15. *Future developments*

Actuarial work is still evolving. Consequently the areas of work that fall within the scope of the Accounts TAS may be subject to change. We consider it important that this TAS should not limit development in actuarial work. This may be particularly relevant within insurance accounting with the introduction of IFRS Phase II

RESPONSE TO SPECIFIC QUESTIONS

Q1. Should there be a separate TAS for actuarial information used for accounts and other financial documents? Respondents are asked to consider the benefits to the users of actuarial information (including the preparers of accounts and auditors) and to practitioners complying with BAS standards. (paragraphs 1.17 to 1.20)

From a pensions perspective we agree that a separate Accounts TAS makes sense. The principles and requirements for accounting differ from those required for funding and other regulatory requirements. For example, users of accounting information tend to be company directors and readers of accounts, whereas users of other pensions work are for the most part pension scheme trustees and regulatory authorities. The Pensions TAS (BAS Consultation Paper, June 2009) was developed on the assumption that a specific TAS for financial reporting would be introduced separately and exclude accounting for pensions.

However, from an insurance perspective (both life and general) we do not believe an Accounts TAS is required. This is because the Insurance TAS appears to cover the relevant points that will appear in the Accounts TAS, and the users of both are often one and the same. The Insurance TAS is largely designed to extend the scope of the reporting, data and modelling TASs to cover non required/reserved roles.

Given the principles-based nature of the TASs, it could be feasible to extend the scope of the Insurance TAS to include items currently falling under the Accounts TAS, on the basis that the actuarial principles to be followed are essentially the same, even though the results are calculated under different regulations.

Q2. Will the proposed purpose of the TAS on actuarial information used for accounts and other financial documents that is set out in paragraph 2.7 help to ensure that users of actuarial information can place a high degree of reliance on its relevance, transparency of assumptions, completeness and comprehensibility?

Yes, subject to our comments on Question 1 above and certain paragraphs of Section 2 as follows:

2.3 and 2.7(b). The role of the auditor is very different to investors and other readers of accounts (as acknowledged in paras 4.32 and 4.33). In accordance with International Standards on Auditing (UK & Ireland) ("ISA") 620, 'Using the work of an expert', auditors are able to use the work of an expert, such as an actuary, in forming their opinion on the financial statements.

The auditor will need to obtain an understanding of the assumptions and methods used and to consider whether they are appropriate and reasonable, based on the auditor's knowledge of the business and the results of other audit procedures. The auditor must evaluate the scope and appropriateness of the expert's work as audit evidence.

In order to make the necessary distinction clearer, we suggest that auditors are placed in a separate category in 2.7. Having said this, as set out in our Main Observations above, we consider that audit-related work should be excluded from the scope of a TAS.

2.9 and 3.2. We believe that the definition of materiality, as provided within the Accounts TAS, may cause confusion because the term is defined differently in auditing. Materiality is defined in the IASB's 'Framework for the Preparation and Presentation of Financial Statements' as follows:

"Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement."

A clearer explanation of the differences in these concepts should be included within the Accounts TAS. Note that paragraph 2.1 of GN36, which will be deleted when the Accounts TAS is finalised, includes more detail regarding accounting materiality.

Q3. Do respondents agree that the proposed scope of the accounts TAS should be the provision of actuarial information for the preparers or auditors of any accounts or related financial documents which are required by statute or other regulations (including stock exchange listing rules) but excluding those produced solely for the use of regulators? (paragraph 4.6) If respondents believe that the scope should be different they should set out their preferred approach with reasons.

We broadly agree with the above approach. However, there may be situations where the actuary produces information with the sole intention of meeting regulatory requirements, but that information could be subsequently used to form the basis of accounting definitions, something which the actuary may not have foreseen. In this situation, the actuary would do well to clearly state, on the face of the deliverable, the purpose for which the document has been produced i.e. for regulators with a caveat that it should not be used for any other purpose.

As embedded values are not required by statute or regulations, it may be appropriate for the Accounts TAS to be extended to cover embedded value work and other similar items produced under a form of principles or guidance rather than statute or regulations.
Please note our response to question 1 with respect to insurance where the insurance TAS covers the issues and as such it would be simpler to avoid including Insurance within the accounting TAS.

Q4. Do respondents agree that provision of actuarial information for preliminary statements of annual results should be in the scope of the accounts TAS? (paragraph 4.27)

Yes, subject to our comments in response in Question 1.

Q5. Do respondents agree that provision of actuarial information for material which is made publicly available, but which is not required by any formal rules or regulations, should be in the scope of the accounts TAS? (paragraph 4.30)

Yes we agree that the provision of actuarial information on pensions which is made publicly available should be in the scope of the Accounts TAS. However, we do not agree that public information on insurance should be covered by the same TAS. As we mentioned in our response to Question 1, we believe that insurance information should only be covered by the Insurance TAS.

The information covered under Paragraphs 4.27 and 4.30 should be consistent. If financials appear in both a preliminary results release and also an analyst pack accompanying it, then both should be subject to the same TAS.

Q6. Do respondents agree that provision of actuarial information for internal budgeting exercises for management should not be in the scope of the accounts TAS? (paragraph 4.35)

Yes,No but actuaries should be advised to caveat the information provided for budgeting by limiting its use solely to that purpose so as to avoid conflict with the scope in paragraph 4.6 of the Accounts TAS. It is only by properly defining the purpose that one will be able to accurately identify that information which will fall under the Accounts TAS and that which will not.

Q7. Is there any other work which respondents believe should be within the scope of the accounts TAS? (section 4)

Yes. Pension actuaries often become involved in calculations for other long term benefits (e.g. long service awards) and share based payments. These should be addressed in the Accounts TAS as either being in scope or not in scope, with reasons given. Share based payments in particular could have a knock-on effect on paragraph 4.25 relating to directors' remuneration.

In addition, we propose that paragraph 4.15 is extended to clarify whether the valuation of a pension scheme's insured benefits (in the asset value) falls under the scope of the Accounts TAS. In order to clarify the scope of the Accounts TAS, it would be useful to give some examples in paragraph 4.36 (e.g. a German pension scheme that reports into the UK would be covered).

Q8. Are there any data issues specific to accounts and other financial documents which respondents believe should be covered by principles in the accounts TAS? (section 5)

For preparation of actuarial information for accounts we do not believe that there are any additional data requirements beyond those already covered within the generic Data TAS which should be separately covered.

Q9. Do respondents have any comments on the proposals concerning assumptions that are presented in section 6, and in particular on the principles proposed in paragraphs 6.6, 6.9, 6.10, 6.13 and 6.17?

Paragraphs 6.6 through 6.9 address the basis of selecting assumptions for a particular purpose. In the context of financial reporting we expect that accounting standards should take precedence in setting guidelines for selecting assumptions, and that further guidance should be developed in, for example, the Insurance TAS. This should therefore preclude the suggestion in paragraph 6.8 that company directors may be seen to adopt inappropriate assumptions in certain circumstances.

Of course some assumptions will be difficult to justify when data used to inform those assumptions is limited. It would be useful to make this clear in the final TAS.

With regard to paragraph 6.10, it is not possible for the selection of assumptions to take account of all information. However, valid reasons should be given to explain why an actuary chooses to deliberately ignore or exclude specific pieces of information. We suggest the word “all” is deleted from the proposed TAS.

The comments under 6.13 are too specific for a principles-based TAS. Further, mortality is singled out as an assumption which will be covered in specific TASs. Although this is clearly relevant, in some circumstances there will be other assumptions warranting a mention. We suggest making a generic statement to highlight issues that are important to the work in question.

While we see merit in the principle in paragraph 6.17, it exceeds the requirements of FRS 17, which requires only that assumptions be mutually compatible, with no specific requirement for individual best estimate.

Q10. Are there any other principles on the selection of assumptions which respondents believe should be in the accounts TAS? (section 6)

Yes. Some assumptions may be dependent on each other and consistency is important. We would propose that the Accounts TAS produces guidance in these situations. A common example is where different assumptions are linked to inflation. The underlying inflation assumption should be consistent.

Q11. Do respondents have any comments on the proposed principle regarding materiality levels for accounting purposes in paragraph 7.4?

Auditing and accounting standards contain a clear definition of materiality (please refer to point 2 above). In our view, the Accounts TAS should use a similar definition of materiality to avoid confusion.

Q12. Are there any specific issues relating to modelling and calculation work for actuarial information provided for accounts and other financial documents which respondents believe should be covered by principles in the accounts TAS? (section 7)

We believe that the generic TAS provides sufficient information and principles for modelling and calculations. There is no need to include further information and principles in the Accounts TAS.

Q13. Do respondents have any comments on the proposed principles on reporting in paragraphs 8.4 and 8.6?

Requiring actuaries to indicate where within a range a selected assumption falls, as stated in paragraph 8.4, is too subjective and potentially misleading or meaningless to a reader of the report. This is because:

Assumptions are often specific to the particular characteristics of a scheme and workforce. For example, a general range for an assumption, e.g. salaries increase at between 0% and 4% above annual inflation would be meaningless for a business in a particular sector with no history of (or planned) future real increases. Indeed, quoting such a range could give the incorrect inference that a 2% assumption was middle of the road, whereas in reality it could be deemed materially prudent by the auditor.

Further, in most situations there will not be a single methodology to derive an assumption, but a number of different valid methods, each with its own range and within each a small amount of discretion. For an actuary to assess every possible methodology would require additional work, leading to additional costs for the client. Furthermore, the accounting standards require "best estimate" assumptions. Given the uncertainty and judgement this involves, we agree it is important for the user of the information to understand that there could be more than one "best estimate", effectively creating a range within which a best estimate assumption might sit. However, formally setting boundaries for this is impractical and potentially misleading.

We also feel that the proposal stated in paragraph 8.6 could be useful for the auditors, but it should not necessarily be required. This is because monitoring any changes between funding and accounting positions can require significant time resource and could lead to confusion, as the purposes and timings of the two calculations are unrelated.

Q14. Are there any other principles on reporting which respondents believe should be in the accounts TAS? (section 8)

No.

Q15. Do respondents have any views on whether accounts TAS should require the user to be given an indication of the time constraints for actuarial work in relation to reporting pension costs for company accounts? (paragraph 9.6)

We do not see why the Accounts TAS should require the actuary to give an indication of time constraints for pension costs, as limited time constraints is not a defence against improper reporting. If this is an issue which BAS wishes to cover, the best place to deal with it, in our opinion, would be in the Actuarial Profession's ethical standards.

Q16. Do respondents have any comments on the proposed transitional arrangements from the adopted GNs to TASs described in section 9?

As with other TASs, we want to ensure that if early adoption is encouraged, that users are clear as to the extent to which they are able to disregard GNs that are still in force.

The changeover from Guidance Notes to TASs is intended to provide a move more towards principles and away from detailed guidelines, which we fully support. However, there are useful elements in GN36 that should be retained in the Accounts TAS. Examples include a definition of materiality as a technical accounting term (paragraph 2.1) and specific requirements of an auditor (paragraph 3.2).

Finally, we note the absence of any discussion on GN12 (general insurance) in relation to a transition to the Accounts TAS, where general insurance is likely to come within the scope of this TAS. We encourage BAS to address this matter, in the same way that it did for the Insurance TAS.

OTHER SPECIFIC OBSERVATIONS (not otherwise covered)

16. In paragraph 3.5 there is a comment regarding judgements being exercised in a "reasoned and justifiable" manner. It would be helpful if BAS could clarify whether there will be a formal requirement for this to be documented under the Accounts TAS.

17. There is a typographical error in paragraph B13 where "used for" is repeated in the first sentence.

CONCLUSION

In our view the challenge of introducing an Accounts TAS begins and ends with its scope. If there is too much overlap with other TASs (e.g. Insurance and Pensions) or potential conflict with standards that govern other areas of expertise (e.g. auditing), the new TAS might do more harm than good. For this reason our response to this Consultation Paper has been cautiously optimistic.

We acknowledge the importance of TASs and recognise their contribution to actuaries and users alike, but there is little margin for error. This means, in effect, that if the challenges highlighted in our response cannot be resolved to the satisfaction of BAS and the wider actuarial profession, we would expect BAS to withdraw its proposal for an Accounts TAS. For this reason we welcome this consultation and the opportunity to remain engaged throughout BAS's due process.

We hope our response is helpful and respectfully ask BAS to publish it alongside other responses shortly after the consultation closes. If you would like further clarification on the points raised by Ernst & Young, please contact me at your convenience.

Yours sincerely

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