

GN7: The Role of Actuaries in Relation to Financial Statements of Insurers and Insurance Groups writing Long-term Business and their Relationship with Auditors

Classification

Recommended practice

MEMBERS ARE REMINDED THAT THEY MUST ALWAYS COMPLY WITH THE PROFESSIONAL CONDUCT STANDARDS (PCS) AND THAT GUIDANCE NOTES IMPOSE ADDITIONAL REQUIREMENTS UNDER SPECIFIC CIRCUMSTANCES

Legislation or Authority

Companies Act 1985 (1985 c.6). (“Companies Act”)

Companies Act (Insurance Companies Accounts) Regulations 1993 (“1993 Regulations”)

Auditing Guideline 311 (Life Insurers in the United Kingdom) issued by the Auditing Practices Committee (and subsequently adopted by the Auditing Practice Board) (“Auditing Guideline 311”)

ABI Guidance Note - Accounting for Insurance Business (Excluding Accounting for Investments) 1995 (“Modified Statutory Guidance Note”)

Insurance Companies (Accounts and Statements) Regulations 1996 (“Supervisory Returns”)

ABI Statement of Recommended Practice (SORP) on Accounting for Insurance Business (Nov 2003) (“*ABI SORP*”)

ASB Financial Reporting Standard 18 - Accounting Policies (“*FRS18*”)

Auditing Practice Note 20 – The Audit of Insurers in the UK (“*PN20*”)

APB Statement of Auditing Standards 520 – Using the Work of an Expert (“*SAS 520*”)

Council Directive 2002/83/EC – Life Assurance Directive (“*Insurance Directive*”)

Application

This Guidance Note has been issued to give advice to:

- Actuaries calculating the long-term business provision for inclusion in the financial statements of a UK authorised insurance company, a friendly society, or a UK domiciled insurance group;

- Other actuaries involved in the preparation of financial statements under the Companies Act, or equivalent friendly society legislation, for companies, societies, or groups transacting long-term insurance business and domiciled in the United Kingdom;

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Status

Approved under Due Process (technical amendment).

<i>Version</i>	<i>Effective from</i>
1.0	01.01.80
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1.2	[1985-86]
1.3	01.09.90
2.0	01.12.91
3.0	01.11.97
3.1	31.12.04

Adopted by BAS on 19.05.06

Ceased to apply from 01.10.11

1 Introduction

- 1.1 Schedule 9A of the Companies Act, introduced by the 1993 Regulations, requires that technical provisions for long-term insurance business be shown explicitly in the annual financial statements and hence they fall within the scope of the audit.
- 1.2 This Guidance Note explains the professional duties of the various parties in relation to the financial statements under the 1993 Regulations and the relationships between them.
- 1.3 The 1993 Regulations have introduced a new professional role for the actuary. The actuary fulfilling this role is referred to in this Guidance Note as the Reporting Actuary.
- 1.4 The 1993 Regulations require an insurance company writing long-term insurance business to have a Reporting Actuary. In the case of an insurance holding company, however, it may be possible for the company to consolidate the results of its subsidiaries without the involvement of an actuary and hence for holding companies the role of Reporting Actuary may not exist. Any actuary who is in any doubt about whether or not he or she is fulfilling the role of a Reporting Actuary should seek clarification of his or her status from the company's directors.

- 1.5 This Guidance Note does not apply to a pension scheme actuary notwithstanding that calculations performed by such an actuary may have implications for the company's financial statements.
- 1.6 An actuary working for a friendly society is expected to interpret this Guidance Note appropriately, having regard to the relevant legislation for friendly societies. The relevant legislation is not included under Legislation or Authority above.

2 The Directors

- 2.1 The directors of an insurer writing long-term insurance business or of an insurance holding company are responsible for all statements made and amounts shown in financial statements prepared under the Companies Act. To the extent that these statements contain amounts calculated by an actuary, the directors will be placing reliance on the professional expertise of the actuary to calculate the amounts. Nonetheless the directors remain legally responsible for the preparation of the financial statements and ensuring that they give a true and fair view of the state of affairs, and results of, the company.
- 2.2 As explained in 3.2 below, it is perfectly proper for the directors to give instructions to the Reporting Actuary on the general approach to be adopted in carrying out his or her work.

3 The Reporting Actuary

- 3.1 The 1993 Regulations state that for the long-term business provision, in the case of an insurance company, the "computations shall be made annually by a Fellow of the Institute or Faculty of Actuaries on the basis of recognised actuarial methods, with due regard to the actuarial principles laid down in Council Directive 92/96/EEC" (subsequently repealed by 2002/83/EC). For group accounts, in the case of a subsidiary having a head office outside the UK the computation shall be made "by an actuary or other specialist in the field on the basis of recognised actuarial methods". The "making of the computation" requires the exercise of professional judgement and hence an individual actuary must provide that judgement. This actuary is referred to as the Reporting Actuary in this Note.
- 3.2 The Reporting Actuary's principals are the directors of the organisation to whom he or she reports, and as mentioned in 2.2 above it is perfectly proper for the directors to give the Reporting Actuary instructions regarding the broad approach to be followed in the calculation of the long-term business provision. However, the Reporting Actuary should be aware that readers of the financial statements will be placing reliance on the figure shown and in this regard the requirements of the Professional Conduct Standards as regards duties to third parties are relevant.
- 3.3 The Reporting Actuary needs to be familiar with accounting principles and current auditing practice as well as the relevant regulations. This is because the

computations are being made within a Companies Act framework where a different methodology may be applicable to that appropriate for a solvency test. Moreover, the application of the accounting principles in SSAP 2 is open to interpretation in any particular circumstance. It is recommended that, prior to carrying out the calculations, the Reporting Actuary ensures that the Auditor is aware of the approach which it is proposed to adopt in any situation where there is particular uncertainty regarding the application of these principles.

- 3.4 The great majority of accounting issues under modified statutory reporting which are relevant to the Reporting Actuary are dealt with in the Modified Statutory Guidance Note. The Reporting Actuary should be familiar with the relevant sections of this Note. On occasion, the Modified Statutory Guidance Note will not cover the situation faced by the Reporting Actuary and, in these circumstances, the Reporting Actuary may need to seek advice on the correct interpretation of accounting principles.
- 3.5 The Reporting Actuary may choose to base the calculation of the long-term business provision on the equivalent mathematical reserves but where this is the case the Reporting Actuary retains full responsibility for the calculation of the long-term business provision. In calculating the long-term business provision under the modified statutory approach, the Reporting Actuary will need to modify the reserves to comply with the Modified Statutory Guidance Note, for example by reducing the level of provision established for contingencies. Modifications may also be necessary if assets are valued on a different basis, for example by using an amortised cost basis for fixed interest securities, and to reflect any explicit asset representing deferred acquisition costs (and associated deferred tax).
- 3.6 The Reporting Actuary may reach different professional judgements from those made for the purpose of the Supervisory returns but should defer to the directors on matters regarding policyholders' reasonable expectations. For example, if the Reporting Actuary's advice is sought as to the relative amounts of the long-term business provision, the fund for future appropriations and the reserves for shareholders, the Reporting Actuary should consult with the directors to ensure that policyholders' reasonable expectations are appropriately recognised.
- 3.7 The Modified Statutory Guidance Note permits the policyholder liabilities of overseas subsidiaries incorporated into group accounts to be computed on a local basis, provided that basis follows the principles of the modified statutory approach. Where it is proposed that the long-term business provision of an overseas subsidiary be consolidated using local GAAP or statutory reserves, the Reporting Actuary should ensure that the accounting conventions used to determine such provisions are not materially different from those of the modified statutory basis. The Reporting Actuary will have to consider the relationship between the long-term business provision and the deferred acquisition cost asset, together with the approach taken to deferred taxation, in forming this judgement.

- 3.8 It is possible that more than one Reporting Actuary will be required to provide results for an insurer because of the need to report at both company and group level. This could lead to different methods and assumptions being adopted. In these circumstances, the Reporting Actuaries should liaise to ensure that data and realistic assumptions agree, even if the different approaches require different figures to be included in the calculations, for example owing to a differing approach being taken to margins.
- 3.9 There are aspects of work where the Reporting Actuary may be relying on other areas within the company to produce information on which to base his or her calculation of the long term business provision. This information will be subject to audit but it may be inappropriate for the Reporting Actuary to place reliance on the Auditor for its accuracy or completeness as the Auditor may have carried out the work to a different level of materiality from that required by the Reporting Actuary. Further, the Auditor may well take the view that it is inappropriate to extend the scope of the Auditor's work to give comfort to the Reporting Actuary. This is on the grounds that the work of the Reporting Actuary may be regarded as being central to the preparation of the financial statements in which case the Auditor is required to be able to express an independent opinion on it.
- 3.10 The statutory role of the Reporting Actuary is restricted to the calculation of the long-term business provision. It is also likely that actuarial advice will be needed to calculate other elements of the balance sheet and profit and loss account. Examples of where this is likely include the derivation of the technical provisions for linked liabilities and the determination of the deferred acquisition cost asset and its pace of amortisation. Any actuary advising on these other aspects of the financial statements needs to be aware of the accounting conventions adopted throughout the accounts and to ensure that advice given is consistent with them. Experience shows that particular care is needed in the area of deferred taxation, where any test of the recoverability of a deferred acquisition cost asset needs to have regard to the size of any corresponding deferred tax liability.
- 3.11 When reporting under the modified statutory method a company may be required, or wish, to include an item in its balance sheet representing the present value of part or the whole of its in force business. An actuary may be asked to provide guidance on the calculation of the appropriate amount, and the pace of any future amortisation. As in Paragraph 3.11, the Reporting Actuary needs to be aware of the relevant accounting conventions and the requirement for advice to be consistent with this. Similar obligations rest with any actuary asked to provide guidance on reporting under embedded value or similar methods of reporting.
- 3.12 An important part of the Reporting Actuary's work is the preparation of a report to the directors setting out the approach taken to computing the long-term business provision and the material assumptions utilised. Under the modified statutory approach, it may be appropriate to describe only those assumptions which differ from those used to calculate the relevant entries in

the Supervisory Returns where the directors have received a report on these latter assumptions and formed their view. For other reporting regimes and where the long-term business provision under the modified statutory approach is calculated independently of the mathematical reserves to be established in the Supervisory Returns, a report detailing both the method and assumptions is appropriate.

- 3.13 The Reporting Actuary's report should not only address the amounts computed but also recommend suitable disclosure as required by paragraph 46(2) of Schedule 1 of the 1993 Regulations.