THE INSTITUTE OF ACTUARIES OF AUSTRALIA
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GUIDANCE NOTE 251
AUDITOR'S & ACTUARY'S DUTIES - LIFE INSURANCE

APPLICATION

Appointed Actuaries of life insurance companies.

AUTHORITY

This Guidance Note is an appendix to Statement of Auditing Practice (AUP) 22 issued by the Australian Accounting Research Foundation and the Auditing Standards Board.

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1. INTRODUCTION

1.1 The purpose of this Appendix is to identify the audit procedures which should be adopted by the auditor in using the work of an actuary in relation to actuarial valuations, reports and certificates in forming an opinion on the accounts of life insurance companies complying with the provisions of the Life Insurance Act 1945. By virtue of Section 288 of the Companies Act (1981) and relevant State Companies Codes, accounts prepared in accordance with Section 44 of the Life Insurance Act are deemed to comply with the provisions of the CompaniesAct/Codes. This Appendix should not be read as a detailed programme of all audit matters relevant to the audit of such companies.

1.2 Although the accounts of life insurance companies are exempted from the disclosure requirements of the Companies Act/Codes, they must in all other respects fairly represent the financial position of the company.

1.3 The auditor's view of the financial position of a life insurance company has to be formed against the background of life insurance business; for example a life insurance policy may last for the future lifetime of the life insured and its outcome in terms of profit and loss will not be known until it is terminated by death or surrender. However, a value must be placed from time to time on the company's liabilities under policies so that the adequacy of the assets of the relevant statutory fund can be demonstrated and the amount of surplus funds identified. Whilst in Australia the actuarial valuation of policy benefit liabilities is not incorporated into a life company's first schedule accounts, on which auditors are required to report, it is necessary for the auditor to ascertain whether the balance of the revenue accounts is not less than the actuarially determined policy liabilities. The accounts of the company are the responsibility of the board of directors, but the process of valuing and certifying the liabilities under policies is solely the professional responsibility of the actuary.

2. THE ACTUARY AND THE AUDITOR'S RESPONSIBILITIES

General

2.1 The actuary and the auditor, being familiar with each other's objectives and responsibilities, should bring to each other's attention any significant matters of concern which they become aware of in the course of their respective duties, which in their belief may impact on the other's duties.

The Actuary's Responsibilities

2.2 A life insurance company is required to seek the services of an actuary to carry out certain investigations. An actuary is defined in Section 4A in the Life Insurance Act 1945, and may be an employee of the company or an external consultant.

2.3 Part III, Division 5 of the Life Insurance Act 1945, contains the provisions relating to actuarial investigations. The Act requires:

(a) A company to "cause an actuary to make an investigation into its financial condition, including a valuation of its liabilities in respect of its life insurance business and to furnish it with a written report of the results of the investigation". Thus the actuary's investigation covers all activities of the company and is not confined to its life insurance business. The investigations are required at least every five years, but are generally carried out annually, and the findings set out in the actuary's financial condition report.

(b) An abstract of the actuary's report in the form of the Second Schedule to the Act. The Second Schedule contains extensive details of the basis used to determine policy liabilities and surplus and the manner in which surplus may be distributed. A Valuation balance sheet sets out the balance of the revenue account, the policy liabilities and the surplus or deficit.

(c) A statement of the life insurance business, in terms of the Third Schedule to the Act. Generally this is provided only every five years.

(d) That if a company causes an investigation to be made at any other time and the results are made public, an abstract of the report of the actuary must be prepared in the form of the Second Schedule or subject to such modifications as the Life Insurance Commissioner approves.

Separate abstracts and statements are required for each statutory fund and for each class of life insurance business carried out by the company within a statutory fund.

2.4 The actuary must adopt a basis of valuation such as "to place a proper value upon the liabilities having regard to the mortality experience among the persons whose lives have been insured by the company, to the average rate of interest from investments and to the expenses of management (including commission), and shall be such as to ensure that no policy shall be treated as an asset".

2.5 The actuary must also certify whether, in the actuary's opinion, "the value placed on the aggregate value of the liabilities of a statutory fund in respect of policies is not less than the value calculated on the Minimum Basis in accordance with the rules set forth in the Fourth Schedule". The actuary must also give a certificate as to the accuracy of the valuation. If the actuary is an employee of the company, the actuary must also certify as to the accuracy of the valuation data; if the actuary is an external consultant the actuary must state in the Second Schedule what precautions were taken by the actuary to ensure the accuracy of the date.

2.6 Section 49(5) of the Act has the effect, in certain circumstances, of excluding intangible assets from being taken into account in the preparation of a valuation balance sheet.

2.7 A company may, with the approval of an actuary and subject to Section 50 of the Act, pay, allocate or transfer surplus arising following an actuarial investigation in a manner consistent with the instruments constituting the company and its articles of association or other rules. Generally, the actuary recommends the distribution of surplus, and the directors approve such recommendations and have responsibility for the distribution.

2.8 In no event can the sum of the amounts paid or allocated to shareholders and transferred to another statutory fund from the surplus derived from Australian participating policies, exceed one quarter of the amount paid or allocated for the benefit of the owners of those policies.

2.9 The Institute of Actuaries of Australia has issued guidelines concerning the matters that the Institute considers an actuary should address in examining and reporting on the financial conditions of a life insurance company. These guidelines require an actuary to have regard to the bases on which assets of a statutory fund are valued in determining the bases on which the actuary values the policy liabilities. The Institute's Code of Conduct requires an actuary making such an investigation to have sufficient practical experience to do so or to seek the co-operation or guidance of an actuary who is so experienced.

The Auditor's Responsibilities

2.10 The auditor will not have the actuary's professional knowledge but should understand, as a reasonable person but not as an expert, the objectives which an actuary will have in mind when making a formal investigation of the financial condition of a statutory fund.

2.11 In accordance with Section 45 of the Life Insurance Act 1945, an auditor must form an opinion and report as to whether:

"(a) the accounts and balance sheet are in accordance with the provisions of this Act;

(b) the balance sheet truly represents the financial position of the company; and

(c) the books of the company have been properly kept and record correctly the affairs and transactions of the company."

Further, the report required for the purposes of Section 45 must state whether the auditor is satisfied that any apportionments made under Part III, Division 4 of the Act have been made in an equitable manner. In addition, the auditor must attach to the balance sheet a report stating whether any parts of the assets of any statutory fund have been applied in contravention of the Act. The auditor should also have regard to the relevant requirements under various Circulars issued by the Life Insurance Commissioner.

2.12 Before forming an opinion, the auditor should communicate with the actuary making the investigation. The auditor's objectives will be:

(a) To obtain reasonable assurance from the actuary that the assets of each statutory fund are adequate to meet its liabilities.

(b) To ensure that the actuary is aware of:

(i) the value of any asset or assets (namely intangible) to which Section 49(5) of the Life Insurance Act 1945, might apply;

(ii) any change in practice in the preparation of the accounts or exceptional circumstances, which may or may not require disclosure in the accounts, that may affect the balance of any revenue account and hence the amount of surplus to be disclosed or the propriety of any proposed distribution of surplus.

(c) To be satisfied that any distribution of surplus complied with the company's memorandum and articles of association and with Section 50 of the Life Insurance Act 1945.

3. RECOMMENDED AUDIT PROCEDURES

3.1 In connection with matters on which the auditor and the actuary have a common interest, the auditor should consider applying the following audit procedures. They are not exhaustive and the applicability of any or a combination of the procedures depends on the auditor's assessment of individual audit circumstances.

Data Base

(a) Study and evaluate the system of internal control relating to the business data which the company generates and on which the actuarial valuations, reports and certificates are based in order to obtain reasonable assurance that:

(i) there is consistency between the data generated for actuarial purposes and that generated for accounting purposes; and

(ii) the system of internal control is operating satisfactorily.

(b) Discuss with the actuary the nature and adequacy of the procedures and controls used in co-ordinating and processing the business date for the purpose of the actuarial valuation, reports and certificates.

(c) Carry out tests to give reasonable assurance that the controls and procedures in (b) above are operating satisfactorily.

(d) Ensure that the actuary has been notified of any weakness in internal control that the auditor has communicated to the management of the company in connection with the study and evaluation of internal control. Bring to the attention of the actuary any additional deficiencies in the record keeping and other systems of the company of which the auditor may have become aware (for example, due to shortcomings in the company's administration or to delays in the flow of cash or information from third parties).

<u>Actuarial Financial Condition Reports</u>

(e) Enquire whether any of the matters dealt with in paragraph (d) above would affect the reports by the actuary or the outcome of any relevant actuarial investigation.

(f) Enquire as to the actuary's opinion as to whether the aggregate of the liabilities of the company in relation to each class of its life insurance business (determined in accordance with the requirements of the Act) as at the end of the financial year did not exceed the balance(s) of the respective life insurance revenue accounts for each class of life insurance business. The actuary's opinion will be clear from the financial condition report of the actuary.

(g) Read any reports made to the directors on the financial condition of the company, including any relating to the determination and allocation of surplus. Discuss with the actuary any aspects of those reports which are considered relevant to the company's financial position.

(h) In terms of paragraph 2.10 enquire as to:

(i) the actuary's reasons for any alterations in bases or assumptions since the previous valuation;

(ii) the actuary's view on the amount of surplus in relation to the previous surplus;

(iii) the extent to which the surpluses may have been affected by material releases from or additions to provisions or reserves (for example, following a change in the valuation basis); and

(iv) the actuary's view on the implications of (i), (ii) and (iii) for the future emergence of surplus.

(i) Discuss with the actuary the provisions made for activities on which up-to-date information was not available at the time of the valuation.

<u>Correspondence with the Life Insurance Commissioner</u>

(j) Examine correspondence between the company and the Life Insurance Commissioner and discuss with the actuary any matters therein which affect the audit.

<u>Subsequent Events</u>

(k) Consider whether there is a need for any disclosure in relation to events subsequent to balance date that may arise as a result of the finalisation of the actuarial valuation or any other occurrence.

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