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PREFACE

This guide has been developed by the Long-term Insurance Project Group of the South African Institute of Chartered Accountants (SAICA) primarily to provide guidance to members on the auditing requirements of entities registered to carry on long-term insurance business and to highlight the audit issues in that industry.

The guide assumes compliance with International Standards on Auditing (ISA), and discusses the special factors to be considered in the application of ISA to long-term insurers, in particular the audit of policy liabilities. Members are advised to read this guide in conjunction with applicable legislation and ISA, where appropriate, to ensure that all areas are adequately covered in any work that they are undertaking.

Every effort has been made to ensure that the advice given in this guide is correct. Nevertheless this advice is given purely as guidance to members of SAICA to assist them with particular problems relating to the subject matter of the guide and SAICA will have no responsibility to any person for any claim of any nature whatsoever which may arise out of or relate to the contents of this guide.
Introduction

.01 The objective of this guide is to make auditors aware of those areas peculiar to long-term insurance business that they should consider in applying International Standards on Auditing (ISA). This guide is not intended to provide all the detailed knowledge required to audit a long-term insurer.

.02 Throughout this guide, the term ‘long-term insurer’ refers to a person registered or deemed to be registered as a long-term insurer under the Long-term Insurance Act, 1998 (the Act) and authorised to write long-term insurance or reinsurance business in South Africa.

.03 The auditor's primary objective is to report to shareholders on the financial statements of the long-term insurer in accordance with the Act. This necessarily includes determining whether the insurer has raised liabilities appropriate to meet its obligations to policyholders in terms of South African Statements of Generally Accepted Accounting Practice (Statements of GAAP) or International Financial Reporting Standards (IFRS), as applicable.

.04 The focus of this guide is the audit of the financial statements of long-term insurers in accordance with ISA. The auditor is also required to report to the Financial Services Board (FSB) in terms of the Act. These additional reporting responsibilities are summarised in Appendix A. Guidance on the additional audit procedures required to report to the FSB are specifically excluded from the scope of this guide.

Background to long-term insurance business in South Africa

General

.05 The primary purpose of long-term insurance is to provide financial protection to the owner of a long-term insurance policy or contract (the policyholder) from identified events occurring within a specified period in consideration for the payment of a premium.

.06 A distinction must be drawn between an insurance contract as defined in IFRS 4 – Insurance Contracts and a long-term insurance policy as defined in the Act (refer paragraph .06 below). In terms of IFRS 4, an insurance contract is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

.07 There will be instances where an insurance policy in terms of the Act is not accounted for under IFRS 4 as it does not meet the definition of an insurance contract in terms of the standard. As a result, certain contracts will be accounted for differently in the financial statements and the regulatory returns submitted by the long-term insurer to the FSB.

.08 In this guide, as far as possible, the term ‘policy’ is used when referring to a long-term insurance policy as defined by the Act and the term ‘contract’ is used when referring to an insurance contract as defined in IFRS 4. The remainder of this background section discusses policies as defined in the Act.

Sources of business

.09 The following are the two basic sources of business:

• Direct selling. The long-term insurer is in direct contact with the policyholder as a result of advertising, direct mail, a branch network, or a sales force employed by the insurer.
• **Intermediaries.** Insurance intermediaries advise and assist the policyholder in arranging insurance. There are two categories of long-term insurance intermediaries: independent financial advisers and appointed representatives. Independent financial advisers are often referred to as being ‘untied’ agents or brokers while appointed representatives are often referred to as being ‘tied’ agents.

**Long-term insurance policies**

.10 The classes of long-term insurance policies, defined in the Act, are as follows:

• **Assistance policy.** A life policy in respect of which the aggregate of:
  - the value of the policy benefits, other than an annuity, to be provided (not taking into account any bonuses to be determined at the discretion of the long-term insurer); and
  - the amount of the premium, in return for which an annuity is to be provided, does not exceed R10 000, or other maximum amount prescribed.

• **Disability policy.** A policy in terms of which the long-term insurer, in return for a premium, undertakes to provide policy benefits upon a disability event. A disability event means the event of the functional ability of the mind or body of a person or an unborn becoming impaired.

• **Fund policy.** A policy in terms of which the long-term insurer, in return for premium, undertakes to provide policy benefits for the purpose of funding in whole or in part the liability of a fund to provide benefits to its members in terms of its rules, other than such a policy relating exclusively to a particular member of the fund or to the surviving spouse, children, dependants or nominees of a particular member of the fund. ‘Fund’ is specifically defined in the Act as including friendly societies, pension funds, medical schemes and retirement benefit funds.

• **Health policy.** A policy in terms of which the long-term insurer, in return for a premium, undertakes to provide policy benefits covering a health event (including a reinsurance policy in respect of such a policy), but excluding any policy:
  - of which the contemplated policy benefits
    - are something other than a stated sum of money;
    - are to be provided upon a person having incurred, and to defray, expenditure in respect of any health service obtained as a result of the health event concerned; and
    - are to be provided to any provider of a health service in return for the provision of such service; or
  - of which the policyholder is a medical scheme registered under the Medical Schemes Act, 1998,
    - which relates to a particular member of the scheme or to the beneficiaries of such member; and
    - which is entered into by the scheme to fund in whole or in part its liability to such member or beneficiaries in terms of its rules.

A health event means an event relating to the health of the mind or body of a person or an unborn.

• **Life policy.** A policy in terms of which the long-term insurer, in return for a premium, undertakes to provide policy benefits as a result of a life event or to pay an annuity for a
period. A life event means the event of the life of a person or an unborn having begun, continuing, having continued for a period or having ended.

- **Sinking fund policy.** A policy, other than a life policy, in terms of which the long-term insurer, in return for a premium, undertakes to provide one or more sums of money, on a fixed or determinable future date, as policy benefits.

.11 The above definitions include reinsurance policies in respect of the defined policies.

.12 Policies may be entered into by, or on behalf of, individual policyholders or by employers on behalf of a specified group of persons (assuming there is an insurable interest). In general, policies are not cancellable by the long-term insurer unless certain terms of the contract have not been fulfilled; for example, payment of premiums after the statutory minimum period (one month).

.13 Besides the definitions used in the Act, long-term insurance policies can be grouped according to the manner in which benefits are determined or according to the type of insured events on which the payment of benefits is dependent.

**Groupings according to manner of determination of benefits**

- **Linked policies.** The benefit is determined by reference to the market value of a segregated group of assets (or indices) to which the policy is linked. Units are notionally allocated to each policy on the payment of each premium, on the basis specified in the policy, being units in either an internal investment fund of the long-term insurer (an internal linked fund) or an external collective investment scheme (registered in terms of the Collective Investment Schemes Control Act, 2002).

- **With-profit policies**
  - Reversionary bonus policies where the policyholder participates in the surplus (or profits) of the long-term insurer, and the benefit is expressed as a guaranteed minimum sum at the end of the term or earlier death together with bonuses declared during the term of the policy and/or on the termination of the policy.
  - Smoothed bonus policies where a designated portion of the premium is allocated or deemed to be allocated to an accumulation fund where it earns bonuses. As the name suggests, the full effect of good or bad performance is not reflected in the bonuses added, but is smoothed over time. The benefit is determined by reference to the total of the accumulation fund or, in some cases, a stated minimum guaranteed sum assured, whichever is the higher.

- **Without-profit policies.** The policyholder does not participate in the surpluses of the long-term insurer, and the benefit is expressed as a fixed sum at the end of the term or at earlier death, or as a fixed annuity payable immediately or from the occurrence of a future event.

**Groupings according to when benefits become payable**

Fund policies, as defined in the Act, can be either contingent upon an insured event or not. These policies can therefore be included under either or both of the following two categories:

- **Policies contingent upon death, survival or state of health** (this category covers assistance policies, disability policies, health policies and life policies as defined in the Act)
  - **Annuity.** A periodic payment made from a stated or contingent date and continued for a fixed period, or for as long as the annuitant or annuitants live. An annuity may be payable for life, but with a minimum term or for a fixed term (therefore not dependent on survival at all). The regular sum payable may be fixed or rise by an annual
percentage or an annual percentage on the basis of performance (participating or with-profit annuities). Annuities may be written with reference to more than one life, for example, to pay a regular sum where two assureds survive and, following the first death, to pay a lower sum to the survivor for the rest of the survivor’s life.

- **Whole life policy.** A policy in terms of which the long-term insurer, in return for a premium, undertakes to provide policy benefits should the insured event (e.g. death or disability of the insured life) take place. The policy has no defined term but continues for as long as the insured event has not taken place.

- **Term policy.** A policy in terms of which the long-term insurer, in return for a premium, undertakes to provide policy benefits should the insured event (e.g. death or disability of the insured life) take place during the term of the policy. The term of the policy is defined, for example, in years and not by reference to the insured event (as opposed to a whole life policy).

- **Endowment policy.** The policy has a defined term (e.g. number of years). The benefit is payable on the survival of the insured life to the end of the term or at earlier death (or disability if this is an insured event).

- **Health policy.** A policy in terms of which the long-term insurer, in return for a premium, undertakes to provide policy benefits upon a health event.

- Some policies include elements of more than one type of policy mentioned above.

- **Policies not contingent on a life, health or disability event**

  - **Sinking fund policy.** This policy is similar to an endowment policy, except that benefits must be payable at determinable future dates. The continuance of the policy is therefore not dependent on the survival of one or more lives.

**Reinsurance**

.14 Long-term insurers may transfer (or ‘cede’) a part of the risk assured to another registered insurer referred to as a ‘reinsurer’. In this case, the direct insurer is referred to as the ‘cedent’. Likewise, the reinsurer may in turn transfer part of the risk assured to another registered insurer called a ‘retrocessionaire’. A reinsurance policy does not reduce the long-term insurer's primary obligations to its policyholder – it is a separate policy to which the original policyholder is not a party.

.15 The purpose of reinsurance is to manage and spread risk; for example:

- to protect the capital base from a catastrophe or to prevent over-concentration of mortality risk or morbidity risk;
- to reduce the risk of loss on any one policy, and so to eliminate wide variations in underwriting results; or
- to ensure an increase in the volume of business written, without increasing the capital base to an equivalent extent.

.16 There are two methods of reinsurance – **treaty and facultative.** Under the treaty method of reinsurance, an agreement is entered into between the cedent and the reinsurer in terms of which all risks written by the cedent that fall within the terms and limits of the treaty will be reinsured with the reinsurer. With the facultative method of reinsurance, each risk to be reinsured is offered to the reinsurer, who accepts or rejects it individually. The limits and terms of treaties can be, for example, monetary, geographic or by class of business.
Legislation

.17 The South African long-term insurance industry is a highly regulated industry and long-term insurers have to comply with a variety of different legislation, depending on the nature of their business and the products sold by them. Consequently, this section addresses the most significant legislation with which most of these insurers have to comply, but it is not intended to address all possible legislation applicable to every long-term insurer.

Long-term Insurance Act

.18 The principal legislation governing the conduct of long-term insurance business is the Act. This gives wide-ranging regulatory authority to the FSB.

.19 The Act provides for the issue of regulations on such matters as the registration of long-term insurers, the form and content of returns to be submitted to the FSB, the licence and control of Lloyds' agents, the method of valuing assets and liabilities, and the admissibility of assets for solvency purposes. The Act is supplemented by circulars issued by the FSB.

.20 In order to assist the FSB in monitoring long-term insurers, the Act requires every insurer to prepare and submit to the FSB a return for each financial year.

.21 The Act also contains requirements concerning matters such as:
- the matching of assets and liabilities;
- the localisation of assets and liabilities; and
- the basis of valuation of assets and liabilities.

.22 A long-term insurer is required by the Act to identify the allocation of assets and liabilities attributable to:
- long-term business; and
- other business.

.23 Under section 20 of the Act, the long-term insurer must appoint a statutory actuary resident in the Republic, who must be a Fellow of the Actuarial Society of South Africa (ASSA) with appropriate practical experience relating to long-term insurance business. The statutory actuary's duties are set out in the Act and include carrying out annual investigations into the long-term financial position of the long-term insurer. These investigations involve carrying out an actuarial valuation. The statutory actuary is also required to comment annually on the value, kinds and spread of the long-term insurer's assets and their appropriateness in relation to matching the liabilities of the insurer.

.24 Although the statutory actuary is appointed and remunerated by the long-term insurer, the statutory actuary’s appointment is approved by the FSB and the statutory actuary has statutory responsibilities and obligations to the FSB, which arise from supervisory functions aimed at the protection of policyholders. The statutory actuary also has responsibilities imposed by means of professional duties.

.25 The statutory actuary's main statutory duty is to ensure that the long-term insurance business is operated on a sound financial basis. This involves undertaking regular valuations, satisfying the statutory actuary as to the correctness of data used, and reporting to the board of directors on the results of actuarial investigations and the implications of these results. Should the statutory actuary consider the long-term insurer not financially sound, the statutory actuary
advises the insurer on appropriate actions needed to restore it to a financially sound position. The statutory actuary reports and makes recommendations in respect of any proposed allocation of surplus in the long-term insurer.

.26 For this purpose, the valuation of assets and the determination of liabilities are made in accordance with Schedule 3 of the Act. Statutory actuaries are required to comply with a number of professional guidance notes (PGNs), issued by ASSA in performing the valuation. In particular, the valuation is performed in terms of:

- PGN 103 – *The Report by the Statutory Actuary in the Annual Financial Statements of South African Long-term Insurers*, provides guidance regarding the format and content of the statutory actuary’s report to be included in the annual financial statements of the long-term insurer; and
- PGN 104 – *Life Offices – Valuation of Long-Term Insurers*, provides guidance on the valuation of a long-term insurer’s assets, liabilities and capital adequacy requirements.
- PGN 106 – *Actuaries and Long-term Insurance in South Africa*, sets out the duties and responsibilities of the statutory actuary and other actuaries working for long-term insurers in terms of the Act and provides guidance to statutory actuaries regarding compliance with ASSA’s corporate governance requirements.
- PGN 110 – *Reserving for Minimum Investment Return Guarantees*, provides guidance on reserving adequately for minimum maturity values and other guaranteed benefits arising from minimum contractual investment returns.

.27 For further information refer to the full PGNs, which are available on ASSA’s website.

.28 In particular, Schedule 3 of the Act provides a requirement for the provision of a financial soundness valuation and a report on AIDS, guarantees and the matching of assets and liabilities. The statutory actuary is to be satisfied that the statement of the long-term insurer's liabilities in respect of the long-term business, prepared by the insurer, is correct in so far as it relates to liabilities under unmatured policies and the statutory actuary attests to this.

.29 If any of the above comparisons have not been made, the manner in which the statutory actuary has been satisfied of the suitability of the mortality table used or of the rate of interest used or of the allowance for expenses made in calculating the liabilities should also be stated.

**Companies Act**

.30 Insurance organisations operating as limited companies also fall within the ambit of the Companies Act, 1973. The statutory requirements relating to financial statements presented to members are set out in the Companies Act.

**Income Tax Act**

.31 The Income Tax Act, 1962, requires a long-term insurer to establish four separate funds, and to maintain such funds in accordance with the provision of section 29A of the Income Tax Act. Section 29A of the Income Tax Act provides for the so-called trustee principle of taxing accruals attributable to policies underwritten by long-term insurers. Each such fund is taxed as a separate taxpayer, and their respective taxable incomes are determined according to the ordinary provisions of the Income Tax Act, except in so far as section 29A modifies those rules in relation to long-term insurers.
The funds are divided into three policyholder funds and one corporate fund, as follows:

- **The untaxed policyholder fund.** The long-term insurer allocates into this fund assets that have a market value equal to the net liability of the insurer in respect of:
  - policies owned by or business carried on with any pension fund, provident fund, retirement annuity fund or benefit fund;
  - any policy that is owned by a person who is exempt from income tax under section 10 of the Income Tax Act; and
  - any annuity policies in respect of which annuities are being paid.

The benefits derived by the policyholders are taxable in their hands, and the income of this fund is exempt from tax.

- **The individual policyholder fund,** which represents long-term insurance business conducted with policyholders that are not companies. The long-term insurer allocates into this fund assets that have a market value equal to the net liability of the insurer in respect of policies owned by persons. Income of this fund is taxed at an average rate of tax applicable to the body of individual policyholders. (30% is currently applied).

- **The company policyholder fund,** which represents long-term insurance business conducted with companies. The long-term insurer allocates into this fund assets that have a market value equal to the net liability of the insurer in respect of policies owned by companies. Income of this fund is taxed at the company tax rate.

- **The corporate fund** represents the balance of the assets and liabilities relating to insurance business conducted by the long-term insurer in the Republic. It is taxed at the company tax rate.

Each of the policyholder funds is restricted to holding assets having a net value equal to the long-term insurer’s liabilities to the relevant policyholders. The basis of determining such liabilities is specified in section 29 of the Act.

The long-term insurer is required to revalue the policyholder funds within six months after the end of every year of assessment. If, on revaluation, there is a surplus of assets in any fund, that surplus must be transferred to the corporate fund. If there is a shortfall in any fund, assets must be transferred to that fund from the corporate fund.

It is to be noted that, except for the above, transfers between funds are not permitted.

### The audit of policy liabilities of long-term insurers

#### Introduction and scope

This section of the guide provides guidance on the application of ISA to the audit of policy liabilities of long-term insurers. Policy liabilities are complex accounting estimates and computations that require the specialised expertise of an actuary. The complexity and specialised nature of these estimates require, in almost all circumstances, the presence of an actuarial expert as part of the engagement team. (Refer to ISA 620 – *Using the Work of an Expert*, and ISA 220 – *Quality Control for Audits of Historical Financial Information.)*

One of the auditor's objectives is to obtain sufficient appropriate audit evidence regarding the recognition, measurement, disclosure and presentation of the policy liabilities within the context of the financial statements as a whole. In addition to performing appropriate procedures to test the calculation of the policy liabilities, the auditor also considers such factors as the complexity and subjectivity involved in preparing the policy liabilities, the availability
and reliability of data, the nature and extent of assumptions required, and the degree of uncertainty of future events. The PGNs issued by ASSA require the statutory actuary to develop a point estimate of policy liabilities rather than an estimated range for those liabilities, and different actuaries are likely to arrive at different point estimates, while normally still within a reasonable range, as a result of the inherent uncertainties and judgments required in making such estimates. Differences between such estimates are not necessarily indicative of error where the estimates are within a reasonable range. The auditor should make a final assessment of the reasonableness of the entity’s accounting estimate of the policy liabilities on the basis of the auditor’s understanding of the entity and its environment and whether the estimates are consistent with other audit evidence obtained during the audit. This will enable the auditor to consider a zone of reasonableness within which the auditor will accept the policy liabilities as being reasonable within the context of the financial statements as a whole.

.38 In meeting the objective of the audit, the auditor would consider the following:

- The use of an actuarial expert on the engagement team.
- The role of the statutory actuary in determining the policy liabilities.
- The need for corroborative evidence so that the auditor’s work (including the work of the actuarial expert on the engagement team) provides the principal evidence for the auditor’s opinion.

.39 The guidance provided in this guide is intended to be integrated into the overall audit process by which the auditor obtains and evaluates audit evidence to obtain reasonable assurance about whether the financial statements are presented fairly, in all material respects, in accordance with Statements of GAAP or IFRS, as appropriate. This guide provides guidance in relation to the audit of long-term insurers, in particular, on:

- understanding the long-term insurer and its environment and assessing the risks of material misstatement of policy liabilities (refer ISA 315 – Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement);
- the auditor’s procedures in response to assessed risks of material misstatement of policy liabilities (refer ISA 330 – The Auditor’s Procedures in Response to Assessed Risks);
- using the work of an expert (for example, the statutory actuary) as audit evidence, and using an independent expert when performing audit procedures on policy liabilities (refer ISA 620 – Using the Work of an Expert);
- the auditor’s procedures in response to significant accounting estimates (refer ISA 540 - Audit of Accounting Estimates);
- the audit procedures that the auditor might perform to obtain an understanding of the long-term insurer and its environment, including internal control, relevant to auditing policy liabilities;
- the specified aspects of the long-term insurer and its environment, and components of its internal control the auditor needs to understand in order to identify and assess risks of material misstatement of policy liabilities;
- identifying and assessing the risks of material misstatement of policy liabilities, including determining whether any of the assessed risks are significant risks that require special audit consideration or risks for which substantive procedures alone do not provide sufficient appropriate audit evidence;
- communicating with the audit committee and management about internal control matters with respect to policy liabilities;
• determining overall responses to address risks of material misstatement at the financial statement level, and the nature of those responses, including the use of an independent actuarial expert to assist the auditor with respect to the audit of policy liabilities;

• designing and performing further audit procedures with respect to policy liabilities, including tests of the operating effectiveness of controls, and substantive procedures of which the nature, timing and extent are responsive to the assessed risks of material misstatement at the assertion level; and

• evaluating whether the risk assessment remains appropriate and concluding whether sufficient appropriate audit evidence has been obtained.

Accepting an engagement

.40 In terms of ISA 220 and International Standard on Quality Control 1 – Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Service Engagements, before accepting an engagement, the auditor should consider whether the firm/engagement partner/engagement team has the required capabilities, competence and time to perform the engagement.

.41 The auditor should therefore consider whether his/her understanding of the subject matter is sufficient to enable the auditor to discharge his or her responsibilities. Policy liabilities include complex accounting estimates and computations requiring the specialised expertise of an actuary. In most circumstances, the audit of such estimates requires the use of an appropriately qualified expert. Such expertise will assist the auditor in assessing risk and performing further audit procedures to respond to assessed risk. Therefore, it is likely that, in almost all circumstances, the auditor will only accept an engagement to audit a long-term insurer after serious consideration as to whether it is necessary to have specific actuarial expertise on the engagement team performing the audit.

.42 Some insurance companies are also required to report in foreign jurisdictions. The auditor will need to consider whether the engagement team includes members with sufficient relevant knowledge and experience in auditing policy liabilities valued in terms of foreign reporting standards.

Risk assessment and sources of information about the long-term insurer and its environment, including internal control

Risk assessment

.43 ISA 315.07 requires the auditor to perform the following risk assessment procedures to obtain an understanding of the long-term insurer and its environment, including internal control:

• enquiries of management and others within the long-term insurer;

• analytical procedures; and

• observation and inspection.

.44 In performing such risk assessment procedures, the auditor needs to have an understanding of the role and responsibilities of the statutory actuary, including the statutory actuary’s professional standing, competence, integrity and independence. This understanding is required in situations where the statutory actuary is employed by the long-term insurer and in situations where an external consulting actuary has been appointed as statutory actuary of the insurer. Much of this understanding will be obtained during the planning stage of the audit and should be documented as part of the audit documentation.
It is important that the statutory actuary and the auditor communicate throughout the audit. Both the statutory actuary and the auditor have a duty of confidentiality in respect of the information acquired in the course of working with the long-term insurer. To promote fair presentation in financial reporting, the statutory actuary and the auditor should have the ability to meet when necessary and discuss and disclose to each other, in confidence, information believed by one to be relevant to the work of the other. Before accepting an engagement, the auditor should obtain permission from the insurer to communicate with the statutory actuary. The auditor should consider the impact on accepting the engagement or continuing with the engagement should he/she be refused permission to communicate openly with the statutory actuary.

Historically the statutory actuary and auditor of a long-term insurer have entered into a written record of understanding. A specimen document is no longer provided as part of this guide, but the auditor should consider whether this would be an appropriate means of communicating with the statutory actuary.

In addition to obtaining an understanding of the role and responsibilities of the statutory actuary, the auditor may make enquiries of the statutory actuary with respect to matters such as:

- the industry, regulatory and other external factors, including the applicable financial disclosures;
- the nature of the long-term insurer;
- the objectives, strategies and related business risks of the long-term insurer; and
- measurement and review of the long-term insurer’s performance.

The auditor may also make enquiries of others to understand the long-term insurer and its environment, for example:

- senior management such as the chief financial, risk, investment and information officers, as well as senior line-function actuarial staff, to identify policy liabilities where the greatest use of judgement is used, where new actuarial standards are being used, or where there are changes in systems or practices;
- internal audit personnel, in relation to their activities concerning the design and operating effectiveness of the long-term insurer’s internal control over the valuation of policy liabilities and whether management has satisfactorily responded to any findings from these activities;
- systems personnel, in relation to the long-term insurer’s computerised systems and the long-term insurer’s controls over systems development and programme changes;
- underwriting personnel, in relation to the long-term insurer’s underwriting strategies, sales trends or reinsurance arrangements;
- claims personnel, in relation to the long-term insurer’s claims settlement or reserving practices;
- investment personnel, in relation to asset/liability management, investment strategies and investment valuation practices;
- the audit committee or any specific actuarial committee of the board, in relation to the environment in which the financial statements are prepared and the audit committee’s role in overseeing the actuarial valuation process; and
- regulatory personnel, including review of regulatory correspondence.
.49 Reviewing information obtained from external sources such as insurance industry publications and regulatory instructions may also be useful in obtaining information relating to the policy liabilities of the long-term insurer.

.50 Analytical procedures may be helpful in identifying the existence of unusual transactions or events, and amounts, ratios and trends that might indicate matters that have financial statement and audit implications. Such procedures may be a source of audit evidence about the reasonableness of the policy liabilities. The statutory actuary and other members of management normally will prepare analyses to evaluate the reasonableness of the actuarial valuation or elements of it. These analyses normally fall into three main categories (refer Appendix A):

- comparisons to prior periods;
- comparisons to budget and pricing assumptions; and
- comparisons to industry statistics.

.51 Observation and inspection may support enquiries of management, the statutory actuary and others, and also provide information about the long-term insurer and its environment. Such audit procedures with respect to the audit of policy liabilities include:

- reading reports of the statutory actuary, internal audit department, risk management department and regulators;
- inspection of documents such as business plans, strategies, management accounts and management’s measurement of the amount of, and trends in, available and required capital for regulatory and other purposes (for example, regulatory capital requirement tests);
- reading reports of any peer review or other external actuarial review of the statutory actuary’s work; and
- inspection of any sensitivity analyses of policy liabilities and the surplus to changes in assumptions.

**Discussion among the engagement team**

.52 ISA 315.14 requires the members of the engagement team to discuss the susceptibility of the long-term insurer’s financial statements to material misstatement. As many of the financial statement items in the balance sheet and income statement of a long-term insurer are dependent on the valuation of policy liabilities by the statutory actuary, or affect the statutory actuary’s valuation, members of the engagement team need to understand how the results of the audit procedures they perform may affect the audit of the policy liabilities.

.53 The actuarial expert involved in the engagement should be included in the discussions. Such an expert, who has an in-depth knowledge of the insurance industry, may be able to assist the engagement team in:

- planning the audit of the policy liabilities, including assisting the audit team in corroborating the information obtained about the long-term insurer and its environment;
- documenting the actuarial valuation processes and related control structure;
- performing a walk-through of the procedures to confirm the actuarial valuation processes;
- understanding the susceptibility of the valuation of policy liabilities to material misstatements arising from fraud or error, and in designing further audit procedures to address assessed risks of material misstatement of policy liabilities;
- understanding the risk features of existing and new insurance products;
• explaining the relative conservatism of the policy liabilities and how policy liabilities have changed as compared to the prior year; and

• Performing analytical procedures on the actuarial liabilities and any related analysis of surplus.

**Understanding the long-term insurer and its environment, including internal control**

**Industry, regulatory and other external factors, including the applicable financial reporting framework**

.54 ISA 315.22 requires the auditor to obtain an understanding of the relevant industry, regulatory and other external factors, including the applicable financial reporting framework.

.55 Expectations regarding future industry conditions underlie the assumptions used in the determination of policy liabilities. Current industry conditions and trends are a major source of information in developing expectations about the future. The following are examples of matters that might be considered in developing an understanding of current industry conditions and trends:

- **Changes in general economic, legal and social conditions.** Such changes may result in increased anti-selection by policyholders. Anti-selection is the term used to describe actions by policyholders that may create, prolong or stop a policy benefit when it is to their benefit to do so, to the detriment of a long-term insurer. For example, when the economy goes into recession, life policy lapse rates and disability claims under health or accident and sickness policies may increase significantly. Changes in general economic conditions may mean that actual results deviate significantly from those assumed in product pricing and the valuation of policy liabilities at the end of the previous financial year.

- **The position of the industry in the current business cycle.** Over the long term, the insurance industry goes through various business cycles. Such business cycles range from those where insurance premiums and profitability are rising, while claims and expenses are falling, to those where premiums and profitability are falling and claims and expenses are rising. Long-term insurers respond in different ways depending on where the industry is in the current business cycle. Understanding where the industry is in the current business cycle provides useful information about the reasonableness of assumptions used in the valuation of policy liabilities.

- **Changes in financial markets.** Such changes may significantly affect the long-term insurer's continued ability to manage risks related to liquidity, rates of return on investments, foreign exchange, hedging, credit losses and asset/liability matching, minimum investment returns guaranteed on insurance products and the availability of affordable reinsurance. Changes in financial markets may mean that actual results deviate significantly from those assumed in product pricing and the valuation of policy liabilities at the end of the previous financial year.

- **Changes in regulation, accounting and actuarial standards.** Such changes will alter policy liability requirements, assumptions or calculation methodologies.

- **Changing policyholder needs.** Changes in the social environment and consumer preferences may have a significant effect on the long-term insurer. These changes may make older products obsolete and create increasing demand for newer products. Changes affecting the long-term insurer’s product mix in this way can have significant implications for the valuation of policy liabilities.

.56 South African long-term insurers are required to prepare their financial statements in accordance with Statements of GAAP in terms of the Companies Act. Listed long-term insurers are required to report in terms of IFRS and comply with the JSE Listing Requirements. Some
insurance companies are also required to report in foreign jurisdictions. Foreign reporting standards (such as United States generally accepted accounting principles, including the related actuarial standards and practices) with respect to the valuation of policy liabilities may be different from the reporting standards used in South Africa. In order to value policy liabilities for foreign financial reporting purposes, these companies often require different systems from those used to value policy liabilities in South Africa.

.57 As long-term insurers are subject to regulation in most jurisdictions, the auditor should be familiar with the relevant regulatory material issued by regulators within the applicable jurisdiction.

.58 The auditor considers his or her ability to understand the policy liabilities and the statutory actuary’s work and findings. The auditor is not expected to possess the same understanding of the subject matter as the statutory actuary and may make use of an actuarial expert on the engagement team to assist in this regard. However, the auditor should have the ability to:

• understand the objectives of the statutory actuary’s work and how it relates to the objectives of the assurance engagement;
• consider and conclude on the reasonableness of the assumptions, methods, and source data used by the statutory actuary; and
• conclude on the reasonableness and significance of the statutory actuary’s findings in relation to the objective of the engagement and the auditor's conclusion.

.59 Available literature, previous experience and explanations from the statutory actuary, or the actuary on the engagement team, may enable an auditor to understand policy liabilities sufficiently to complete the engagement. The requirements of ISA 620 – *Using the Work of an Expert*, are relevant in this regard.

**Nature of the long-term insurer**

.60 ISA 315.25 requires the auditor to obtain an understanding of the nature of the business. The auditor obtains an understanding of the long-term insurer’s operations, its ownership and governance, the types of investments that it is making and plans to make, the way that it is structured, and how it is financed.

.61 The auditor obtains an understanding of those product lines that are significant in the determination of policy liabilities and reviews the features of products within those lines that are likely to be significant to the assumptions and data used in the actuarial valuation.

.62 Examples of matters to be considered in obtaining an understanding of product lines include:

• characteristics of the policyholders (for example, information such as gender, geographical location of group policy members, and the population segment at which the product is primarily targeted);
• the standards applied by underwriters in deciding whether to accept or decline applications for insurance;
• how the long-term insurer’s premium and commission rates compare with the industry, and their adequacy;
• product characteristics, product risks, and terms of participating policies;
• the volume, maturity, mix, quality, and rate of return of investments to support the policy liabilities, including the extent of matching of asset and liability duration and maturity;
• administrative or claims handling costs (both internal and external);
- anticipated amounts and patterns for settlement of indemnities (for example, death, disability, and other benefits);
- reinsurance coverages;
- profit entitlement policies for each product type (these policies govern how shareholders derive profit from transactions between the long-term insurer and its policyholders); and
- amounts and patterns of premium receipts and claim payments.

.63 The auditor obtains an understanding of the role and responsibilities of the statutory actuary. Examples of matters to be considered in obtaining an understanding of the role and responsibilities of the statutory actuary and the actuarial methods used include:
- how the actuary communicates with the rest of the organisation, including how the actuary becomes informed about:
  - underwriting decisions including new products, changes in underwriting philosophy, or marketing methods that may affect actuarial assumptions;
  - the frequency of claims, the structure and processes of the claims department, and the existence of backlogs so that these are taken into account in the valuation of policy liabilities;
  - the nature and extent of the long-term insurer’s reinsurance activities, including alternative risk transfer agreements and the impact of the reinsurance programme on policy liabilities;
  - the asset/liability management function, including asset default experience, asset/liability mismatches, reallocations of assets and related liabilities;
  - insurance business in other jurisdictions; and
  - the underwriting and claims handling practices, including those of third party administrators and of ceding companies, and the results of audits;
- how the actuary ensures that source data used in the valuation of policy liabilities is valid, accurate and complete;
- the actuarial methods used in the calculation of policy liabilities and how the statutory actuary ensures that these conform with the appropriate PGNs of the ASSA;
- actuarial assumptions used, including best estimates and margins for adverse deviations and discount rates, and how the statutory actuary compares assumptions with actual experience;
- the extent to which approximations are used in calculating policy liabilities and the procedures for ensuring their reasonableness; and
- the reflection of the asset/liability practices in formulating policy liabilities.

Objectives and strategies and related business risks
.64 ISA 315.30 requires the auditor to obtain an understanding of the business objectives and strategies, and the related business risks that may result in material misstatement of the financial statements. Business risk in a long-term insurer may arise when management:
- changes underwriting policies;
- changes valuation and other information systems;
- rapidly expands or contracts operations, or restructures operations, resulting in staff and other operational changes that affect risk selection or estimates of expenses;
• introduces new or complex products or enters into new reinsurance policies where there may be a lack of significant experience or appropriate information systems from which to derive appropriate assumptions;
• fails to comply with appropriate market conduct practices;
• changes how it manages risks related to liquidity and investments, foreign exchange, hedging, and asset/liability matching; and
• expands or acquires foreign operations with different products and regulatory environments.

.65 In obtaining an understanding of the long-term insurer’s objectives and strategies and related business risks, the auditor might consider the long-term insurer’s:
• strategic plan, including its attitude toward expansion into new lines of business, management of capital, and regulatory compliance;
• investment practices and strategies, including the volume, maturity and mix and rate of return of investments, and the extent of matching of asset and liability duration and maturity;
• underwriting and product profitability objectives, including whether the long-term insurer has taken steps to recruit adequate and experienced personnel (as well as information technology resources) needed to underwrite and administer its business;
• distribution methods, agent and other intermediary selection, compensation, and monitoring of sales practices;
• general business purposes and objectives of its reinsurance programmes, including retention limits, exposure to individual reinsurers and in aggregate;
• claims handling and settlement philosophy;
• risk management programme, the risks identified and management’s responses; and
• results of the statutory actuary’s capital adequacy testing and the sensitivity of the long-term insurer to adverse scenarios as measured by the capital adequacy testing.

Measurement and review of the long-term insurer’s financial performance
.66 ISA 315.35 requires the auditor to obtain an understanding of how the long-term insurer measures and reviews its financial performance.

.67 In obtaining an understanding of how the long-term insurer measures and reviews its performance, the auditor would consider:
• the key performance measures used by the long-term insurer, identifying those where actuarial calculations are of significance;
• the identification of the sources of earnings for analysing the reasonableness of movements in policy liabilities from one period to the next;
• the use of statistics concerning the economic value added by the long-term insurer’s activities; and
• the extent to which the statutory actuary performs studies of mortality, persistence, lapses, premiums, expenses, and the frequency and severity of claims as an assessment of the reasonableness of actuarial assumptions.

Internal control
.68 ISA 315.41 requires the auditor to obtain an understanding of internal control relevant to the audit and ISA 315.43 indicates that internal control consists of:
• the control environment;
• risk assessment process;
• the information system, including the related business processes, relevant to financial reporting, and communication;
• control activities; and
• monitoring of controls.

Controls relevant to the audit of policy liabilities
69 Controls relevant to the audit of policy liabilities include:

• policies and procedures to collect, record and process information used for developing assumptions, and to enhance the reliability of this information, such as:
  - obtaining long-term insurer-specific and industry-wide studies to assess emerging experience for products;
  - making comparisons of valuation assumptions with those used in product pricing, particularly for new products;
  - comparing actual results to past valuation assumptions; and
  - performing cash flow projections and sensitivity analyses to determine the effect on the valuation of various changes in critical assumptions;

• policies and procedures established and maintained to enhance the reliability of the capture and processing of source data, such as:
  - access controls, systems development controls and change controls over programs used in the capture and processing of data;
  - access controls over the in-force database, investment and claims master files and valuation master files;
  - controls over the quality and timeliness of information provided by reinsurance ceding companies, for example, by audits to assess compliance with the administration, underwriting and claims handling policies and procedures of the long-term insurer, and over the timely processing of such information; and
  - record counts and input/output reconciliations to control the transfer, processing and aggregation of source data;

• policies and procedures the statutory actuary may establish and maintain to ensure the valuation models continue to reflect the significant attributes of the business, such as:
  - access controls, systems development controls and change controls over the programs used in the calculation process;
  - reconciliation controls including the reconciliation of system outputs to data used to derive the valuation assumptions (for example, reconciliation of total expenses and premiums to the general ledger);
  - comparison of current period results with the results projected by prior valuations (for example, comparison of current year claims to the claims projected by the previous year's model); and
  - comparison of the model and significant product features (for example, a 25-year term product would not have cash flows in year 26); and
• policies and procedures the statutory actuary may establish and maintain to enhance the reliability of the actuarial calculation process, such as:
  - access controls, systems development controls and change controls over programs used in the calculation process;
  - access controls over master files containing calculation parameters;
  - access controls, systems development controls, and change controls over calculation tools such as spreadsheets and modelling software and controls to ensure that such tools are being used for the purpose for which they are intended;
  - controls over the process for estimating reinsurance assumed amounts;
  - controls over the process for considering, justifying and selecting methods used in calculations;
  - independent checks of logic used in deriving calculations;
  - independent checks of calculations;
  - identifying sources of earnings; and
  - comparisons of current actuarial calculations with those used in prior years, with investigation of any variations that were not anticipated.

Control environment

ISA 315.67 requires the auditor to obtain an understanding of the control environment. In evaluating the design of the long-term insurer’s control environment with respect to the audit of policy liabilities, the auditor might consider management’s:

• commitment to having an actuarial valuation function that:
  - is appropriately staffed by competent people with the necessary experience and professional qualifications;
  - performs its functions with objectivity and in accordance with the ASSA’s professional standards; and
  - has appropriate access to the audit committee or equivalent;

• commitment to oversight by conducting regular reviews of financial performance in order to identify unexpected results and take appropriate action;

• communication and enforcement of integrity and ethical values that are clearly reflected in the design, administration and monitoring of financial controls including those over the valuation of policy liabilities;

• recognition of the need for strong communication links between the statutory actuary and those responsible for managing significant aspects of the long-term insurer's operations (for example, chief executive and financial officers, and management in charge of investments, underwriting, claims, product pricing, marketing and administration);

• general philosophy on establishing policy liabilities and monitoring actual-to-expected experience for the underlying assumptions;

• general philosophy on setting claim liabilities and management's historical record of claim liability adequacy or experience;

• policies relating to establishing liabilities for valid exposure, and adjusting such liabilities in response to changes in risk exposure;
delegation of operational authority to outside parties, such as third party administrators or other service providers, and commitment toward designing appropriate procedures to supervise, control and monitor the performance of those parties;

- self-assessment of its compliance with PGNs issued by ASSA and with regulatory standards for sound business and financial practices; and

- treatment of data from facility associations.

The auditor refers to ISA 315.70 – .71 when considering whether elements of the long-term insurer’s control environment have been implemented.

The long-term insurer’s risk assessment process

ISA 315.76 requires the auditor to obtain an understanding of the process for identifying business risks relevant to financial reporting objectives and for deciding about actions to address those risks, and their results. The auditor enquires about business risks that management and the statutory actuary have identified at the long-term insurer level and considers whether they may result in material misstatement of policy liabilities.

The auditor obtains information about the long-term insurer’s risk assessment process from those responsible for risk management, such as the chief risk officer. The auditor can also obtain an understanding of the effect of business risks on policy liabilities by reviewing reports prepared for the audit committee or equivalent by the statutory actuary. The auditor also discusses with the statutory actuary the results of any capital adequacy testing, including the number, range and variability of scenarios tested.

Information system, including the related business processes, relevant to financial reporting, and communication

ISA 315.81 requires the auditor to obtain an understanding of the information system, including the related business processes, relevant to financial reporting. Because of the large number of transactions, most long-term insurers rely heavily on information technology to maintain statistical and accounting records. The auditor considers the information systems relevant to the valuation of policy liabilities (these systems may be outside the long-term insurer’s main information systems, for example, computer-based systems and spreadsheets, and are often collectively referred to as the ‘in-force database’). These systems comprise in-force, premiums, investments, claims and valuation master files.

The auditor should consider obtaining an understanding of management controls such as

- controls over the integrity of master files;
- controls over transferring information between master files, including information from external sources such as reinsurance ceding companies or third party administrators;
- controls for ensuring that valuation master files have been established and maintained to calculate the value of policy liabilities correctly; and
- controls over transferring information from the valuation master files to the general ledger and vice versa.

In obtaining an understanding of the information system, the auditor considers the risks of material misstatement associated with inappropriate override of controls over the valuation of policy liabilities. In particular, the auditor considers the opportunity for management to override:

- actuarial assumptions;
valuation methods;
- the selection of assets for matching against policy liabilities;
- provisions for adverse deviations; and
- adjustments to computer-produced valuations for new products and products with features not dealt with in the valuation system.

Control activities

ISA 315.90 requires the auditor to obtain a sufficient understanding of control activities to assess the risks of material misstatement at the assertion level and to design further audit procedures responsive to assessed risks. Control activities are the policies and procedures that help ensure that management and the statutory actuary’s directives are carried out. Examples of control activities relating to policy liabilities include the following:

- **Proper authorisation of transactions and activities** – written guidelines are in place that assign appropriate individuals the responsibility for initial approval and subsequent changes of actuarial assumptions and calculation methodologies.
- **Independent checks on calculation of recorded amounts** – actuaries are responsible for selection of actuarial methods and calculations of liability amounts, and policies and procedures are in place to evaluate those methods and calculations and the resulting liability amounts by appropriate personnel.
- **Design of adequate controls over documents and records** – there are procedures to ensure that fictitious or duplicate in-force file records or policy liability records are not included in the records and to prevent and detect the omission of valid transactions.
- **Adequate safeguards of access to and use of assets and accounting records** – policy liability data files and production programs have adequate safeguards against unauthorised access.
- **Segregation of duties between incompatible functions**.
- **General IT controls and application controls** – there are policies and procedures that relate to many applications and maintain the integrity of information and the security of the data IT systems process, and manual or automated procedures at a business process level that are designed to ensure the integrity of the accounting records.

Monitoring of controls

ISA 315.96 requires the auditor to obtain an understanding of the major types of activities that the long-term insurer uses to monitor internal control over financial reporting, including those related to those control activities relevant to the audit, and how the long-term insurer initiates corrective actions to control deficiencies. In a long-term insurer, the effectiveness of internal control over policy liabilities may be monitored in the following ways:

- ongoing management reviews of internal control performance;
- independent audit assessments as part of the compliance with regulatory standards for sound business and financial practices;
- evaluations by internal audit;
- reviewing reports from regulators resulting from their reviews of regulatory filings and regulatory examination reports;
- internal actuarial reviews;
- external actuarial reviews; and
- reviews by reinsurers.
Assessing the risks of material misstatement

.79 ISA 315.100 requires the auditor to identify and assess the risks of material misstatement at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. With respect to policy liabilities, the auditor:

- identifies risks throughout the process of obtaining an understanding of the long-term insurer and its environment, including relevant controls that relate to risks, and by considering classes of transactions, account balances and disclosures in the financial statements;
- compares the identified risks to what could occur at the assertion level;
- considers whether the risks are of a magnitude that could result in a material misstatement of the policy liabilities; and
- considers the likelihood that the risks could result in a material misstatement of the financial statements.

Significant risks that require special audit consideration

.80 ISA 315.108 requires the auditor to determine which of the risks identified are, in the auditor’s judgement, risks that require special audit consideration (such risks are defined as ‘significant risks’).

.81 Because policy liabilities are, in almost all circumstances, complex accounting estimates and computations involving assumptions about future events and requiring the specialised expertise of an actuary, those risks of material misstatement relating to policy liabilities are significant risks. Accordingly, to the extent not already done so, the auditor would evaluate the design of the long-term insurer’s related controls, including relevant control activities, and determine whether they have been implemented. Such evaluation of the design and implementation of controls may include enquiring of long-term insurer personnel, observing the application of specific controls, inspecting documents and reports, and tracing transactions through the information system. Enquiry alone is not sufficient to evaluate the design of a control relevant to an audit and to determine whether it has been implemented.

.82 If management has not appropriately responded by implementing controls over significant risks and if, as a result, the auditor judges that a material weakness in internal control exists, the auditor communicates this matter to those charged with governance in accordance with ISA 260 – Communication of Audit Matters with Those Charged with Governance.

.83 In the view of the volume of transactions in a long-term insurer, considerable reliance is often placed on internal controls (especially those relating to information systems). If the auditor judges that a material weakness in internal controls relevant to the valuation of policy liabilities exists, he or she should consider the possibility that the risks of material misstatement to which these weaknesses relate are risks for which substantive procedures alone do not provide sufficient appropriate audit evidence (refer to ISA 315.115 – .118) and the impact of this on the sufficiency and appropriateness of audit evidence and the audit opinion.

The auditor’s procedures in response to assessed risks

.84 ISA 330.03 requires the auditor, in order to reduce audit risk to an acceptably low level, to determine overall responses to assessed risks at the financial statement level and to design and perform further audit procedures to respond to assessed risks at the assertion level.

Overall responses

.85 ISA 330.04 requires the auditor to determine overall responses to address the risks of material misstatement at the financial statement level. Such responses may include:
• emphasising to the engagement team the need to maintain professional scepticism in gathering and evaluating audit evidence;
• assigning more experienced staff or those with special skills, or using experts; or
• providing more supervision, or incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.

.86 The auditor may also make general changes to the nature, timing or extent of audit procedures as an overall response.

.87 An accounting estimate is the amount included in financial statements to approximate the effect of past business transactions or events or the present status of an asset or liability. Policy liabilities are considered to be an accounting estimate that can have a significant or pervasive effect on the financial statements. Management is responsible for the accounting estimates included in financial statements, including establishing policies and procedures for the preparation of accounting estimates, which would normally include matters such as gathering the necessary data on which to base estimates, developing assumptions as to the most likely outcome, determining the amount of estimates, and considering financial statement disclosure.

.88 The determination of policy liabilities, including the establishment of policies and procedures with respect to the policy liabilities, is performed by the statutory actuary. The auditor would consider this in evaluating the objectivity of the statutory actuary in accordance with ISA 620. In developing overall responses to the assessed risks, the auditor may use the work of the statutory actuary. However, corroborative evidence may be required (including the work of an actuarial expert on the engagement team) to provide sufficient appropriate audit evidence to support the audit opinion.

.89 The auditor, in almost all circumstances, will use an actuarial expert on the audit. The role of such an expert will depend on the circumstances of the audit and may range from extensive involvement in all phases of the audit to a more limited participation in specifically identified areas. Such involvement will depend on considerations such as the nature of the long-term insurer’s major product lines, the adequacy of controls, the qualifications of the long-term insurer’s actuarial resources and the experience of the auditor with regard to audits of policy liabilities of long-term insurers.

**Audit procedures responsive to risks of material misstatement at the assertion level**

.90 ISA 330.07 requires the auditor to design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement at the assertion level. In some cases, the auditor may determine that only by performing tests of controls may the auditor achieve an effective response to the assessed risk of material misstatement for a particular assertion. In other cases, the auditor may evaluate the controls and determine that performing substantive procedures is appropriate for specific assertions and, therefore, the auditor excludes the effect of controls from the relevant risk assessment. This may be because the auditor’s risk assessment procedures have not identified any effective controls relevant to the assertion, or because testing the operating effectiveness of controls would be inefficient. However, the auditor needs to be satisfied that performing only substantive procedures for the relevant assertion would be effective in reducing the risk of material misstatement to an acceptably low level. This may require substantive testing of the computations, modelling, and reasonableness of assumptions used in determining the policy liabilities. Often, the auditor may determine that a combined approach, using both tests of the operating effectiveness of controls and substantive procedures, is effective.
Tests of controls

.91 ISA 330.23 requires the auditor to perform tests of controls when the auditor’s assessment of risks of material misstatement at the assertion level includes an expectation that controls are operating effectively, or when substantive procedures alone do not provide sufficient appropriate audit evidence at the assertion level. Tests of the operating effectiveness of controls ordinarily include the same types of audit procedures used to evaluate the design and implementation of controls, and may also include reperformance of the application of the control by the auditor. The auditor should refer to ISA 330 for further guidance and requirements on tests of controls. Because policy liabilities are significant risks, to the extent not already done so, the auditor should evaluate the design of the long-term insurer’s related controls, including relevant control activities, and determine whether they have been implemented.

Substantive procedures

.92 ISA 330.51 requires the auditor to perform substantive procedures that are specifically responsive to significant risks. Because risks of material misstatement of policy liabilities are, in almost all circumstances, significant risks, the auditor performs substantive procedures to address such risks.

Procedures where actuarial assistance may be useful/necessary

.93 The following are areas where the actuarial expert, as part of the engagement team, could assist in performing substantive procedures on policy liabilities:

- Assessment of the reasonableness of the data in the actuarial analysis, identification of important data for testing, evaluation as to whether the data used is appropriate and enquiry of the statutory actuary as necessary.

- Review of the actuarial analysis for reasonableness, including:
  - appropriateness of the level of detail used (line of business, accident year vs. policy year, claims made vs. occurrence, gross vs. net methods applied, assumptions used, judgements made, loss recognition and premium deficiency aggregation level, and average age/underwriting class/face amount model points chosen);
  - appropriateness of methods used (consistency with authoritative practice and industry practice);
  - appropriateness of assumptions in light of experience and other information;
  - review of reinsurance transactions to assess risk transfer and appropriateness of accounting treatment;
  - judgements made;
  - selections made;
  - completeness of valuation; and
  - completeness of documentation included in actuarial analysis.

- Testing of the policy liabilities to determine if they are being calculated consistent with the indicated methodology and assumptions. The testing would confirm that the documented methodology is being accurately applied in the valuation model and that the assumptions are used appropriately. For a long-term insurer, the actuarial expert would test specific policy liabilities and other actuarial balances, typically at the policy level, depending on the nature of the calculation.

- Reading of the statutory actuary’s report and dialogue with the statutory actuary regarding consistency of the statutory actuary’s report with the statutory actuary’s understanding of the
underlying data, methods and assumptions used in developing the policy liabilities as well as industry experience.

- Discussion of the asset/liability management strategy and implications for the policy liabilities with the statutory actuary.
- Reading of any capital adequacy testing report and discussion of significant implications for the policy liabilities.
- Review of the policy liabilities financial statement note(s) for completeness and accuracy.

The extent of assistance would be impacted by such factors as the complexity of the policy liabilities, the auditor's cumulative knowledge of the integrity of the policy liability reserving process, the effectiveness of the internal control structure, the degree and nature of changes in policy liabilities in the current year, and other changes in areas impacting on the policy liabilities.

Evaluating the sufficiency and appropriateness of audit evidence obtained

ISA 330.68 requires the auditor to evaluate whether the assessments of the risks of material misstatement at the assertion level remain appropriate. This evaluation is primarily a qualitative matter based on the auditor's judgment. Such an evaluation may provide further insight about the risks of material misstatement of policy liabilities and whether there is a need to perform additional or different audit procedures. The auditor would conclude whether sufficient appropriate audit evidence has been obtained to reduce to an acceptably low level the risk of material misstatement in the financial statements. In developing an opinion, the auditor considers all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements. If the auditor concludes that he or she is unable to obtain sufficient appropriate audit evidence, he/she would modify the audit report accordingly.

If, on the basis of the audit evidence obtained, the auditor concludes that the financial statements are materially misstated, he or she would request that management address the material misstatement. If management does not appropriately address the misstatement, the auditor should modify his/her report accordingly.

Communicating with the audit committee or equivalent and management

ISA 315.120 requires the auditor to make those charged with governance (the audit committee or equivalent) or management aware, as soon as practicable, and at an appropriate level of responsibility, of material weaknesses in the design or implementation of internal control that have come to his or her attention. Risks of material misstatement for which the relevant control is inadequate, or material weaknesses in the long-term insurer’s risk assessment process, are communicated to the audit committee or equivalent in accordance with ISA 260.
APPENDIX A – OTHER RESPONSIBILITIES OF THE AUDITOR IN TERMS OF THE ACT

Reportable irregularities

.01 In terms of section 45 of the Auditing Profession Act, 2005 (APA), the auditor has a duty to report on irregularities to the Independent Regulatory Board for Auditors (IRBA). Auditors should refer to the guide issued by IRBA, Reportable Irregularities: A Guide for Registered Auditors (RI guide), for additional guidance.

.02 In terms of section 19(5)(a) of the Act, the auditor is required to send a copy of the report submitted to IRBA to the Registrar. In terms of section 19(5)(b) of the Act, if the auditor’s appointment is terminated for any reason, including resignation, the auditor has to submit to the Registrar a statement of what the auditor believes to be the reasons for that termination and if the auditor would have had reason to submit a report as contemplated in terms of section 45 of the APA he/she should submit such a report to the Registrar. Refer to the RI Guide for guidance on reportable irregularities in light of the auditor’s withdrawal from the audit engagement.

Reporting of matters that may prejudice the long-term insurer’s ability to maintain its business in a financially sound condition

.03 In terms of section 19(5)(c) of the Act, the auditor assesses the likelihood that transactions or conditions that may prejudice the long-term insurer’s ability to maintain its business in a financially sound condition will be encountered during the audit of the financial statements.

.04 These procedures do not constitute an extension of the scope of the audit of the financial statements because the auditor is not changing the nature, extent and timing of auditing procedures performed during the audit.

.05 The auditor on the basis of the auditor’s knowledge of the long-term insurer’s business, assesses whether any transactions or conditions encountered during the audit of the financial statements are to be reported to the FSB.

.06 Such transactions or conditions include:

- transactions or conditions that necessitate a change in accounting basis, or require disclosure, because of doubts about the validity of the going concern assumption;
- other transactions or conditions giving rise to significant risks or exposures that have the potential to jeopardise the long-term insurer’s future ability to continue as a going concern, including speculative investment transactions, concentration of investment transactions in specific sectors of the economy, and insufficient segregation of duties resulting in an increase in risk;
- transactions or conditions indicating that the long-term insurer has significant weaknesses in internal control, which render it vulnerable to significant risks or exposures that have the potential to jeopardise the insurer’s ability to continue as a going concern;
- transactions or conditions necessitating a modified audit opinion;
- transactions or conditions contradicting the assumption of management’s good faith; and
- transactions or conditions contravening capital adequacy or liquidity requirements.
07 It is important that the auditor not only assesses the significance of the individual transactions or conditions encountered but also consider whether or not a combination of these items indicates the existence of transactions or conditions that are to be reported to the FSB.

08 The auditor discusses the findings with the appropriate levels of management, including the board of directors (including the audit committee).

09 The auditor’s report is to be in accordance with requirements contained in the relevant ISA. The auditor’s report is to note that it is to be used to satisfy the requirement contained in section 19(5)(c) of the Act and is not to be referred to or used for any other purpose. If the auditor assesses that the likelihood of transactions or conditions are prejudicial to the long-term insurer’s ability to maintain its business in a financially sound condition the auditor should

• report to the FSB in terms of section 19(5)(c) of the Act;
• consider the guidance in the RI guide to report the irregularity to the IRBA; and
• refer to ISA 570 – Going Concern, to determine the effect on the audit report.

**Auditor’s responsibilities**

10 The auditor has reporting responsibilities in addition to the responsibility to report to shareholders on the annual financial statements.

11 However, it is to be noted that neither the requirement to provide the FSB with a copy of a report contemplated in section 45 of the APA nor the requirement to inform the FSB of matters relating to the affairs of the long-term insurer, which may prejudice the insurer’s ability to maintain its business in a financially sound condition, requires the auditor to perform auditing procedures in addition to those performed in the normal course of the audit of the financial statements. However, the auditor does have a general duty of care in relation to matters that could reasonably be expected to have come to the auditor’s attention in the conduct of an audit and are to be recognised as matters of concern. These reporting responsibilities relate to reportable irregularities and other matters of which the auditor became aware in the performance of the auditor’s functions as auditor of the long-term insurer.

12 In order to satisfy the auditor that statements forming part of the statutory return submitted to the FSB are properly drawn up so as to comply with the requirements of the Act, and to present fairly the matters dealt with in the statutory return, the auditor performs procedures relating to the matters included in the relevant statements of the statutory return. These procedures would be in addition to those carried out to form an opinion on the financial statements.