

NAIC Model Audit Rule (MAR)

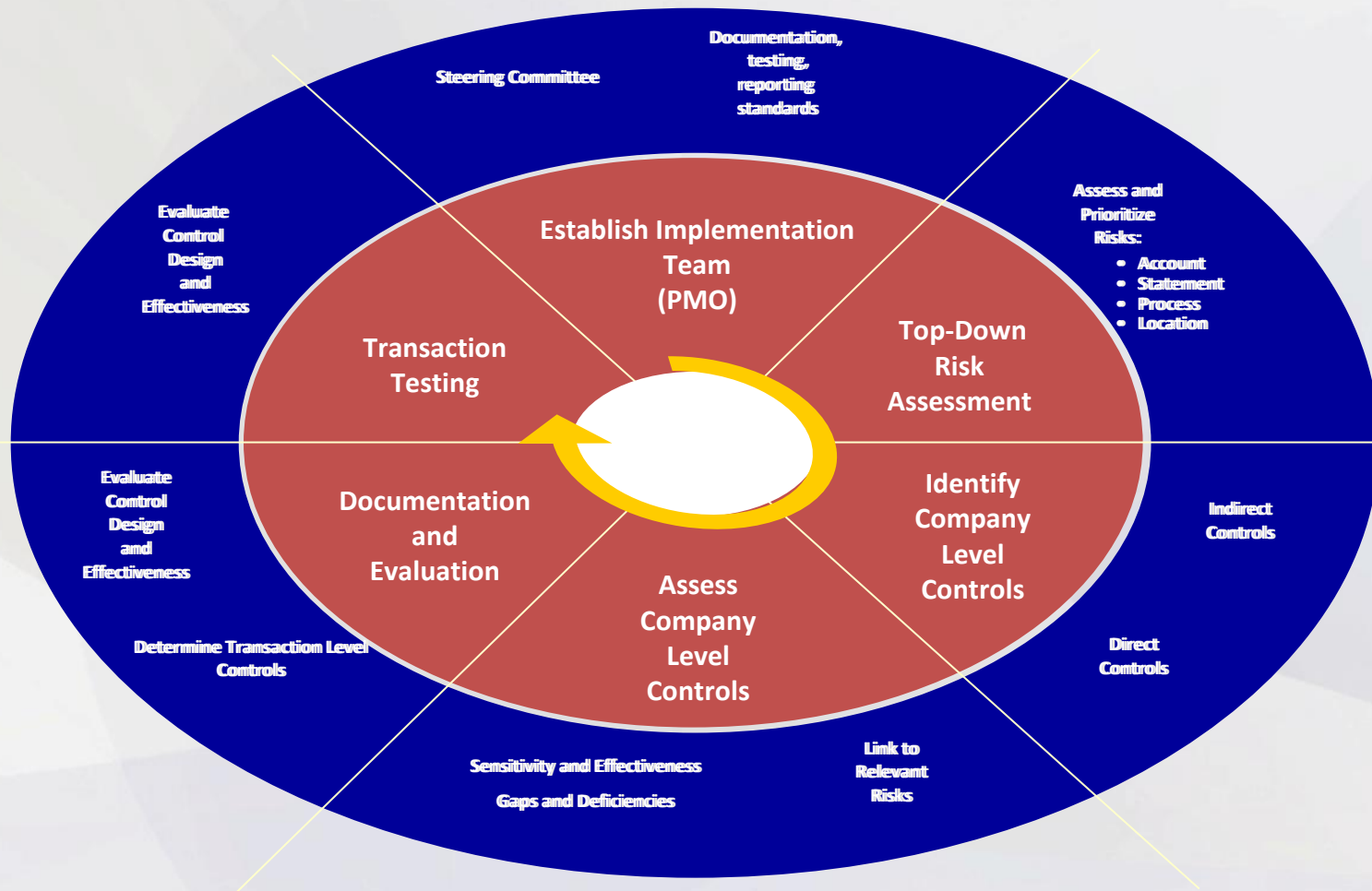
- Agenda
 - American Academy of Actuaries – MAR Practice Note
 - Overall MAR process – Top/Down Risk-Based Approach
 - MAR – Health Actuary Perspective
 - Q&A

American Academy of Actuaries

– MAR Practice Note

- Targeted draft release – Fall 2010
- Contents of Practice Note
 - Section 1 Introduction
 - Section 2 Overview of Control Structure
 - Section 3 Covered Processes in Determining Actuarial Balances
 - Section 4 Documentation of Processes
 - Section 5 Identify Risks
 - Section 6 Identify and Design Key Controls
 - Section 7 Testing of Controls
 - Section 8 Input to the Attestation
 - Section 9 End User Computing
 - Section 10 Key Areas of Actuarial Involvement
 - Section 11 Conclusion

Overall MAR process – Top/Down Risk-Based Approach



Overall MAR process – Top/Down Risk-Based Approach

Issues you face

- Compliance by 2010
- Difficulty identifying material risks to financial reporting
- Lack of requisite skills and approaches
- Prone to control deficiencies in the more technical areas
- Need for early remediation and implementation
- Over-scoping
- Need for consistent documentation across diverse functional areas

Overall MAR process – Top/Down Risk-Based Approach

Benefits to you

- Early identification of potential weaknesses
- Leverage for state financial exams
- Maximize reliance on Company and Entity Level Controls
- Minimize documentation and testing at the Transaction Level
- Eliminate trial and error (filtering)
- Focus on key risks and controls
- Objective insight into remediation

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Key Areas of Actuarial Involvement

- Documentation of reported liabilities/reserves and related actuarial items
- Identify Key Risks
- Designing and Documenting Controls

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Documentation of reported liabilities/reserves and related actuarial items

- Process Narrative
- Process Flowchart

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Process Narrative – should include

- Who performs the process
- Who peer reviews the process results
- Who uses the results of the process or process sub-steps
- Timing of the process results signoff
- Process dependencies
- Process outputs
- The procedures for reporting of process outputs
- Footnote references linked to the Process Flowchart and Risk-Control Matrix

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Process Flowchart – should include

- Information/Data Sources
 - Data Warehouse
- Actuarial Analysis
 - Complex decision trees for various actuarial methods and assumptions
- Peer review
 - Multiple levels and signoffs
 - Multiple levels of adjustments to assumptions and results
- Process Outputs
 - Multiple Sources
- Footnote references linked to the Process Narrative and Risk-Control Matrix

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Identify Key Risks

- Preliminary data input
- Analysis of model results
- Reporting of the process results

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Preliminary data input – Common Risks

- Data may be inaccurate or incomplete
- Data integrity may not be consistent across regions and/or lines of business
- Data (claims paid) may not reconcile to reported financial data
- Data transfer from data warehouse (IT driven applications) to the actuarial data storage files may be inaccurate and incomplete
- Data loading from the actuarial storage files to the reserving model/application may be inaccurate and incomplete

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Actuarial Analysis of Model Results – Common Risks

- Inadvertent corruption of the model/application formulae by unauthorized personnel
- Model/application is not up-dated correctly for current valuation
 - Prior valuation balances
 - Prior valuation actuarial assumptions
 - Current valuation preparations
- Model/application worksheets are not security protected (may be a IT protocol)
 - Worksheet formulas are not password/range/protected
 - Model/application stored on “open access” network drives
- Improper actuarial assumptions/judgments/manual adjustments in analysis phases
 - Lack of adequate documentation of subjective manual adjustments to model driven results (i.e., claims, trend, and completion factor manual adjustments)
 - Lack of formal documentation of the peer review process (if it is not written the assumption is that the activities were not performed)

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Reporting of Process Results – Common Risks

- Inaccurate reporting of actuarial reserve results
- Inappropriate aggregation of actuarial reserve results based on reporting requirements
- Lack of reconciliation of booked financial to actuarial reported/approved reserve numbers

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Designing and Documenting Controls

- Objective is to identify the controls that provide reasonable assurance that:
 - Errors relating to each of the relevant financial statement assertions are prevented (Prevent Controls)
 - Any errors that occur during processing are detected and corrected (Detect Controls)
- Identify controls related to the initiation, recording, processing, and reporting of transactions
- Consider both prevent and detect controls

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Designing and Documenting Controls

Risk-Control Matrix

- Controls referenced to the risks highlighted in the process narrative and flowchart
- Detailed descriptions of control activities
- Type of control (detective or preventive)
- Detailed descriptions of control objectives
- Evidence of control (signoffs/documentation)
- Gap analysis – remediation plans

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Designing and Documenting Controls

Gap Analysis – Remediation

- Most companies underestimated the number of control deficiencies
- Sensitive/higher risk areas were often tested later in the year and resulted in more deficiencies requiring evaluation at year-end
- Inexperience with evaluating the results of testing sometimes resulted in identifying deficiencies late in the year
- Significant judgment was required to evaluate some deficiencies

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Control Deficiency

Does not necessarily indicate that poor actuarial work has been performed just that the actuarial work has been performed in an environment that might allow poor actuarial work to occur undetected

Q & A

Questions ?