

BERMUDA MONETARY AUTHORITY

INSURANCE DEPARTMENT

GUIDANCE NOTE #6

ROLE OF THE APPROVED AUDITOR

MARCH 2005

GUIDANCE NOTE: ROLE OF THE APPROVED AUDITOR

Introduction

- 1 The role of the Approved Auditor is integral to the Bermuda insurance supervisory model. The Approved Auditor's primary role is to express an independent and objective opinion on whether the statutory financial statements are free of material misstatements and whether the statutory financial returns comply with certain criteria established in the Act. This Guidance sets out guidance on the role of the Approved Auditor. The Guidance Notes are intended to provide information on the application of the Insurance Act and corresponding regulations.
- 2 The Bermuda Monetary Authority (the "Authority") recognizes the need for clarity as to the scope and implementation of the provisions of the Act ¹ if the regulatory system is to command the confidence of insurers and policyholders. It seeks, therefore, to ensure that those operating in Bermuda have a good understanding of the nature of the requirements and of the Authority's approach in implementing the Act.
- 3 While the Authority aims to provide clarity as to its approach, this Guidance is not intended to be exhaustive. The Authority, through the Guidance, hereby sets out its understanding of the legal provisions affecting the role of the Approved Auditor, and to provide additional information about the Authority's regulatory approach and expectations regarding these matters. ² Interpretation of statutes is ultimately a matter for the Bermuda courts and the Authority. (The applicable sections of the Act are shown in brackets.) ³
- 4 Other guidance issued by the Authority may contain additional information on the criteria and approval process for the Approved Auditor.
- 5 The Authority's guidance is of general application and seeks to take account of the wide diversity of institutions that may be licensed under the Act. There may

¹ The insurance legislation is comprised of the Insurance Act 1978 (as amended by the Insurance Amendment Acts, 1981, 1983, 1985, 1995, 1998 and 2001) and the regulations promulgated under that Act (the "Regulations"). The Regulations are the Insurance Accounts Regulations 1980 (as amended by The Insurance Accounts Amendment Regulations 1981, 1985 and 1989) and the Insurance Returns and Solvency Regulations 1980 (as amended by The Insurance Returns and Solvency Amendment Regulations 1981, 1985 and 1989). References herein to the "Act" are to the Insurance Act 1978 (as amended) and the Regulations.

² The legislative summary in this Guideline is not intended to be a substitute for provisions of the Act. The reader is advised to refer to the provisions of the Act and not to rely on the interpretation of those provisions contained in this Guideline.

³ "IA" means the Insurance Act 1978. "IAR" means the Insurance Accounts Regulations 1980. "IRASR" refers to the Insurance Returns and Solvency Regulations 1980.

be a need for revision of the Guidance Notes from time to time. Material changes in the Guidance will be published, generally through the issue of a revised version.

- 6 Guidance should be understood as reflecting the minimum standard that the Authority expects insurers and Approved Auditors to observe at all times. For references in these Guidance Notes with respect to the changes in legislation contained in the Insurance Amendment Act 2004 insurers and Approved Auditors must take immediate steps to ensure they are in compliance with the Act. In relation to other matters contained in the Guidance Notes, the Authority encourages insurers to come into compliance as soon as possible and, in any event, not later than 31st December 2005 or a later date as may be agreed with the Authority in a particular case.

Application

- 7 This guidance applies to all insurers registered under the Act and to all auditors approved by the Authority as the Approved Auditor of the insurer.

Appointment of Approved Auditor

- 8 Every registered insurer must appoint an independent auditor, based in Bermuda, who is to report annually on the statutory financial statements of the insurer (IA 16(1)). The auditor may be the same natural person or firm of accountants that reports to the shareholders. Although the company shareholders appoint the auditor⁴, each insurer must obtain the Authority's approval for the independent auditor's appointment as the "Approved Auditor" (IA 16(2)).
- 9 If an insurer fails to appoint an approved auditor, or at any time fails to fill a vacancy for such auditor, the Authority may appoint an approved auditor for the insurer and shall fix the remuneration to be paid by that insurer, if not sooner agreed by the insurer and the auditor, within fourteen days (IA 16(7)).

Appointment at Time of Registration

- 10 Prior to registration the insurer is to notify the Authority, in writing, of its proposed Approved Auditor. The Authority will confirm its approval of the proposed candidate. The Authority will consider appropriate notice to have been given when the name of the candidate for Approved Auditor is included in the pre-incorporation documentation and the letter of acceptance attached thereto.
- 11 If any of the information included in the first notice to the Authority changes, the insurer shall within 14 days, provide written notice to the Authority of the changes (IA 8(3)).

⁴ Pursuant to Section 89(1) of The Companies Act 1981.

Change in Approved Auditor

- 12 If there is to be a change in the Approved Auditor, the insurer shall within 14 days provide written notice to the Authority of the change and the reasons for the change.⁵
- 13 Where there is to be a change in the Approved Auditor, the insurer must obtain the Authority's approval for the new Approved Auditor. If any of the information provided to the Authority as part of the approval process for the Approved Auditor changes, the insurers shall within 14 days provide written notice to the Authority of the change.⁶
- 14 Pursuant to The Companies Act 1981, no person shall accept appointment or consent to be appointed as auditor of a company if he is replacing an auditor who has resigned, been removed or whose term of office has expired or is about to expire, or who has vacated office, until he has requested and received from that auditor a written statement of the circumstances and the reasons why, in that auditor's opinion, he is to be replaced. However, a person may accept an appointment or consent to be appointed as auditor of a company if, within fifteen days after making the request referred to in that subsection, he does not receive a written statement as requested.⁷
- 15 If an insurer proposes to remove an appointed auditor before the expiration of his term of office, or proposes to replace an approved auditor with a different auditor at the expiration of his term of office, the insurer shall give written notice to the Authority forthwith (IA 16(8)).
- 16 Where an Approved Auditor resigns, becomes aware that it will cease to be the Approved Auditor of an insurer, or intends not to seek to be reappointed, the Approved Auditor shall forthwith give written notice to the Authority (IA 16A(1)).

Disqualification

- 17 The Authority may require that an insurer remove a person occupying the role of Approved Auditor, where the person is not fit and proper for the role (IA 16(4)). Criteria for disqualification could include, but is not limited to, where the person:

⁵ IA 8(3) provides that if any of the prescribed particulars about the Approved Auditor, submitted alter, the insurer is to notify the Authority within fourteen days.

⁶ Section 8(3) provides that if any of the prescribed particulars about the Approved Auditor, submitted alter, the insurer is to notify the Authority within fourteen days.

⁷ Pursuant to sections 89(3A) (3B) of The Companies Act 1981.

- is not independent;
- has failed to perform adequately and properly the functions and duties of such an appointment; or
- does not meet the eligibility criteria for such an appointment of Approved Auditor.

The Authority has issued guidance on the Fit and Proper Criteria for the Approved Auditor. This guidance should be referred to.

- 18 The Authority shall not revoke its approval unless it has first notified the auditor and the insurer of its intention to do so (IA 16(5)).

Letter of Undertaking

- 19 Any newly appointed Approved Auditor shall provide the Authority with a letter of undertaking that it will perform its functions in accordance with the Act and the standards issued by the Institute of Chartered Accountants of Bermuda (“ICAB”).

Requirement for Audited Statutory Financial Statements

- 20 The Insurance Act requires an insurer to prepare annual statutory financial statements, which are to be audited annually by the insurer’s Approved Auditor. (IA 15(1), IA 15(4))

- 21 Among other purposes, these statutory financial statements are:

- to be in a form that enables comparison between the insurer's business for the current financial year and for the immediately preceding financial year (IA 15(2));
- shall contain information calculated (IA 15(3)):
 - (a) to give as early warning as possible to any person examining the statements (whether by way of notice of the observance or non-observance by the insurer of any margin of solvency, or in any other way) of any financial or operational difficulties into which the insurer's business has fallen or might appear likely to fall;
 - (b) to provide the basis on which the Authority or any other authority may in good time take action under this Act or any other statutory provision to exercise any statutory power available to him or it for the safeguarding of any element of the public interest involved in or affected by the insurer's business.

- 22 Each insurer is required to keep copies of the statutory financial statements, notes and auditor's report at its principal office for a period of five years from the filing date. (IA 17(2))

Requirement for Statutory Financial Returns

- 23 All insurers are required to prepare and submit to the Authority annual statutory financial returns. (IA 18)

Auditor's Examination

- 24 The Authority expects the Approved Auditor to conduct its audit in accordance with generally accepted auditing standards ("GAAS"). The Authority expects that U.S., Canadian, U.K. or International GAAS would generally be followed. Where an insurer can demonstrate to the reasonable satisfaction of the Authority that circumstances exist where GAAS from another jurisdiction may be an appropriate selection, the Authority may approve the use of GAAS, other than U.S., Canadian, U.K., or International GAAS.
- 25 In the event that an insurer wishes to use GAAS from a jurisdiction, other than U.S. Canadian, U.K., or International GAAS, the insurer should seek preliminary discussions with the Authority so as to identify the issues that would need to be addressed prior to the Authority approving a modification under section 56 of the Act.

Right to Information

- 26 The Authority expects that an insurer will make any arrangements that are necessary to enable the auditor to perform its role. These arrangements would normally include ensuring that the Approved Auditor is fully informed of the Authority's requirements for the insurer (such as any conditions on its license or any section 56 accounting modifications.) In addition, the insurer should ensure that its Approved Auditor has access to all relevant data and people that it reasonably believes is necessary to fulfill its obligations. This includes giving its auditor a right of access to its accounting and other records, in whatever form they are held. In complying with this, the insurer should ensure that any of its suppliers under a material outsourcing arrangement (e.g. claims management, information technology support) gives the Approved Auditor the same rights of access.

Approved Auditor's Report

- 27 The Approved Auditor is to prepare a report to be included with the annual statutory financial return filed by the insurer (IRASR 5). The auditor's report is to be in the form prescribed by the Authority, and is to be signed by the Approved Auditor and addressed to the Authority.

- 28 In its report the Approved Auditor is required to report that he has carried out an examination of the insurer's statutory financial statements in accordance with generally accepted auditing standards.⁸ The report should state the applicable jurisdiction for the GAAS applied.
- 29 The auditor is further required to express an opinion on the following:
- Whether the statutory financial statements have been prepared in accordance with the requirements of the Act insofar as such provisions relate to accounting and financial reporting matters;
 - Whether the Solvency Certificate and Declaration of Statutory Ratios comply, in all material respects, with the criteria of the Act; (IRASR 7(1)) and
 - Whether it was reasonable for the persons signing such solvency certificate to have arrived at the opinions expressed in the certificate, insofar as the opinions relate to accounting and financial matters.
- 30 An auditor is to qualify his report and include his observations, as he considers necessary, for bringing the nature and effect of the qualification to the attention of the Supervisor. (IRRSR 7(2) and (3)) A qualification is required in the following circumstances:
- (a) There were deficiencies in the audit consisting of:
 - (i) Inability of the auditor to obtain essential information; or
 - (ii) Restrictions on the scope of the audit; or
 - (iii) Some other deficiency or deficiencies;
 - (b) The auditor disagreed with any valuation made in the statutory financial statements;
 - (c) In some respect or respects the statutory financial statements or the certificates of solvency or the declaration of the statutory ratios do not in his opinion comply with the requirements of the Act or any applicable Regulations;
 - (d) The auditor considered an opinion or opinions expressed in a solvency certificate unreasonable; and
 - (e) The auditor considered that there was a significant doubt as to the insurer's ability to continue as a going concern (of insolvency risk).

⁸ (IRASR 7(1)(a)) currently provides that report is to be prepared in accordance with accepted auditing standards.

- 31 Where an Approved Auditor decides to include a material modification of his report on the insurer's statutory financial statements and in particular, a material qualification, a denial of his opinion or a statement of adverse opinion, the Approved Auditor shall forthwith give written notice to the Authority (IA 16A(1)(d)). The Auditor shall, as soon as practicable thereafter, furnish the Authority with a copy of his report (IA 16A(2)).

Access to Working Papers

- 32 The Statement of Principles issued by the Authority, pursuant to section 29F, provides that the Authority, using the powers under 29A, will conduct routine prudential meetings and visits with insurers. In order to verify information for regulatory purposes, the Authority may send a letter to the Approved Auditor of the insurer requesting the auditor to confirm that the auditor will cooperate with the Authority in its inspection process by providing access to the auditor's working papers. The Authority expects that the Approved Auditor will write to the insurer to confirm the insurer's understanding and to give the approved Auditor permission to provide access to the auditor's working papers. The Approved Auditor should send the signed cooperation letter back to the Authority. As a result of access to the Approved Auditor's working papers, the Authority should be able to focus more on governance and risk areas in their field inspections.
- 33 With respect to any information obtained from the Approved Auditor's working papers, the Authority shall comply with the confidentiality sections of the Insurance Act.

Communication with the Authority

- 34 No duty to which an auditor of an insurer may be subject shall be regarded as contravened by reason of his communicating in good faith with the Authority, whether or not in response to a request made by the Authority, any information or opinion on a matter which is relevant to any function of the Authority under the Insurance Act (IA 16A(3)). This applies to any matter of which an approved auditor of an insurer becomes aware in his capacity as auditor and which relates to the business or affairs of the insurer or any affiliate of that insurer (IA 16A(4)).

Reliance on Specialists

- 35 When the Approved Auditor uses the work of a specialist, such as an actuary or loss reserve specialist, as audit evidence in the performance of its examination of an insurer, in accordance with the Act, the Authority expects this reliance to be in compliance with GAAS.

End of guidance note.

If you have questions on this or other guidance from the Insurance Department please email info@bma.bm . Please put "Insurance Guidance" in the title of your email.