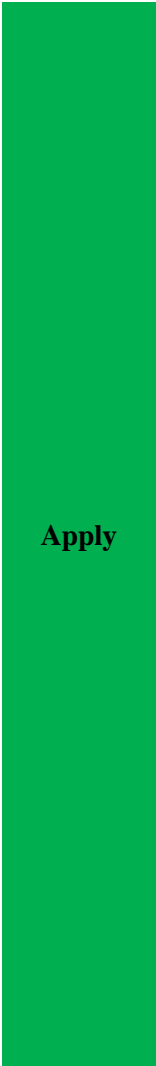


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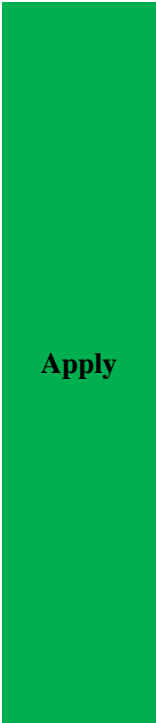
**Phase 1 – Understand the Company and Identify KFAs to be Reviewed**

Sound Practices in Conducting C-Level Interviews:



- Meet with the department analyst prior to scheduling interviews to adequately transfer regulatory insights gained during the period between examinations
  - Consider inviting the primary analyst involved with the company to participate in the C-Level interviews
- When scheduling interviews,

Sound Practices in Overall Corporate Governance Assessment:



- Leverage the Corporate Governance Annual Disclosure (CGAD) filing and related analysis documentation as a starting point for assessment
  - Consider validating the information covered in the CGAD on a test basis, particularly if requested by the analyst
  - Highlight any inconsistencies or key information missing from the CGAD in the SRM for communication back to analysis
- Focus review of board and committee minutes on the most recent year-end of the examination.







**Phase 4 – Determine Residual Risk**

Residual Risk is assessed by determining how well the risk mitigation strategies/controls mitigate the level of inherent risk in the insurer’s activities. In limited circumstances it may be appropriate to adjust the calculated residual risk by applying examiner judgment.

Use of Judgmental Residual Risk:

<b>Apply</b>	<ul style="list-style-type: none"> <li>• Document an appropriate rationale when deviating from the calculated residual risk, especially when reducing the residual risk assessment (e.g., from “High” to “Moderate”, or from “Moderate” to “Low”).</li> </ul>
<b>Avoid</b>	<ul style="list-style-type: none"> <li>• Feeling obligated to document a rationale when the calculated residual risk provides an option (e.g., “High or Moderate”, “Moderate or Low”)</li> </ul>

**Phase 5 – Establish/Conduct Detail Examination Procedures**

In Phase 5, the nature and extent of detail testing to address residual risks is determined and testing is conducted and documented to support exam findings and conclusions.

<b>Apply</b>	<ul style="list-style-type: none"> <li>• Ensure proper workpaper documentation, including clear references or hyperlinks to test work performed</li> <li>• Ensure sample sizes are appropriate (Consider utilizing Exhibit O)</li> <li>• Ensure nature and extent of testing is commensurate with the residual risk assessment</li> <li>• New risks that arise prior to or during this phase (that did not exist as of the balance sheet date) may warrant further investigation (e.g., adding a risk to Exhibit V or a key activity matrix) depending upon their nature and significance.</li> <li>• When leveraging third-party</li> </ul>
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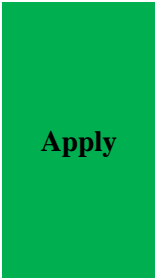
**Phase 6 – Update Prioritization and Supervisory Plan**

Relevant and material findings resulting from the risk assessment effort and other examination activities should be utilized and incorporated into determining (or validating) the priority of the insurer, as well as establishing the ongoing Supervisory Plan. The examination team should utilize the Summary Review Memorandum to

**Phase 7 – Draft Examination Report and Management Letter**

The Examination Report should cover significant findings of fact, as well as general information about the insurer and its financial condition as outlined in the Handbook. The Management Letter (if used) should communicate significant results and observations noted during the examination that are not appropriate or necessary for inclusion in the public report.

**Examination Report Sound Practices:**



- Ensure that findings and recommendations listed in the report relate to findings of fact
- For coordinated examinations, consider the

**Other Examination Sound Practices**

The following sound practices apply more generally to the risk-focused examination, rather than applying to a specific phase.

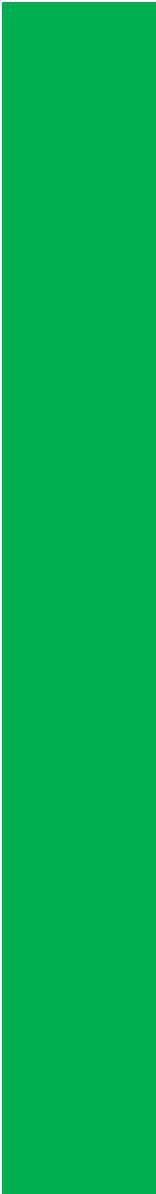
**Sound Practices in Identifying and Addressing Prospective Risks:**

<b>Apply</b>	<ul style="list-style-type: none"><li>• Identify and investigate prospective risks throughout the first 5 phases of the exam</li><li>• Perform independent testing when appropriate but recognize that a review of prospective risks will often focus on the insurer’s ability to manage them</li><li>• Recognize the significance of prospective risks facing the company and ensure that investigation and testing of these risks is prioritized<ul style="list-style-type: none"><li>◦ Depth of investigation for prospective risks should be similar to depth of investigation for traditional key activity risks.</li></ul></li><li>• Share results of the prospective risk assessment with the department analyst</li></ul>
<b>Avoid</b>	

<b>Apply</b>	appropriate. Refer to the Coordination FAQ on page 12 of this document for further information on using contractors in coordinated examinations.
<b>Avoid</b>	<ul style="list-style-type: none"> <li>• Utilizing more contractors than can be adequately trained, monitored and supervised</li> <li>• Using multiple contract examination firms on a coordinated group if possible</li> <li>• Assigning too many concurrent projects to one department designee</li> </ul>

Supervisory Review Sound Practices:

<b>Apply</b>	<ul style="list-style-type: none"> <li>• Challenge inherent risk assessment when areas that generally have high risks (e.g., reserving) do not have any “high” inherent risks identified</li> <li>• Consider the balance of Other Than Financial Reporting risks to Financial Reporting risks when reviewing key activities, and encourage examiners to focus on OTFR risks</li> <li>• When the same procedure or control is linked to multiple risks, challenge if the risk statements are too.</li> </ul>
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- Obtain current year workpapers prior to finalizing exam to ensure any issues identified are



## Appendix

### Appendix A – Example Reliance Memos

This appendix provides examples of CPA Reliance Memos taken from actual risk-focused examination files submitted for peer review and cited for demonstrating some of the sound practices outlined above. Users are not expected to copy or replicate the work performed, but to reference it in considering a range of potential practices in this area. With each example, a brief note is provided to highlight the sound practice(s) identified in the work. Information has been changed/redacted as necessary to protect the confidentiality of the work performed.

#### Appendix A: Example #1

##### ADDITIONAL SUPPORT FOR RELIANCE ON INDEPENDENT AUDIT FUNCTION

A general review of the audit function of the insurer is documented at Exhibit E (hyperlinked above). In addition to the general review and conclusions, the exam team developed the following documentation to provide additional support for the conclusion to reduce the review of financial reporting risks in certain areas.

##### Independent Audit Function

Examiners requested, reviewed and assessed selected work papers in accordance with Section 13 of the NAIC Annual Financial Reporting Model Regulation. ABC Audit performed an integrated GAAP audit on the Company and issued statutory-basis financial.

Key areas of review include:

- Investment valuation and impairment
- PC and Life deferred acquisition costs (GAAP)
- Income taxes
- Goodwill (GAAP)
- Pension plans
- Stock-based compensation (GAAP)

Entity-level Control characteristics were: 002 Tw 14 (ny ) Tu cs wert (i)2.3 (on pl)202 Td(-)Tj(m)5.1 .4 (r)21 .4 (r)21 .7 (c.002





Appendix A: Example #2

**MEMO**

TO: File  
FROM: Examiner  
RE: Reliance on work performed by ABC (External Auditors) to reduce testing of financial reporting risks  
DATE: June 15, 2014

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In addition to the general review of the insurer's audit function, documented at Exhibit E, this memo documents the exam team's review of certain audit workpapers for purposes of reducing the number of financial reporting risks selected for review in these areas:

**Cash & Investments**

Cash handling risks were mapped and control testing was performed (1000). ABC noted cash account controls meet all the control objectives and have been properly implemented, no exceptions were noted. ABC judgmentally selected 25 bank balances to confirm as of 12/31/2013 (1000.2), accounts were reconciled to the GL and a sample of outstanding checks was tested. ABC requested a copy of the last check issued in 2013 and the first check issued in 2014 from significant operating accounts; the checks were in sequential order and dated appropriately for the correct period. No exceptions were noted related to cash account balances.

Investment account risks were mapped and control testing was performed (3000). ABC noted investment account controls meet all the control objectives and have been properly implemented, no exceptions were noted. Independent investment confirmations were obtained and balances were reconciled to the GL. ABC engaged Standard & Poor's Security Evaluations (SPSE) as a specialist for the purpose of providing fair value estimates of certain classes of fixed income securities. No valuation issues were noted. Sample



Appendix A: Example #3

ABC Insurance Company and Affiliates  
Review of XYZ Audit Workpapers  
Exam as of 12/31/13

Purpose: To document the examination team’s review of work performed by the Company’s external auditor XYZ.

Conclusion: The examination team will place reliance on XYZ audit work to reduce the number of financial reporting risks reviewed during this examination.

Reliance on Audit Work in Federal Income Taxes Function

The examination team assessed the external audit function as competent and we intend to place reliance on XYZ control testing and substantive procedures performed around the Company’s Federal Income Tax functions. The examination team’s review of the XYZ workpapers identified comprehensive internal control testing and substantive procedures addressing the Company’s significant financial reporting risks.

The following summarizes key components of XYZ 2013 audit procedures:

Controls Testing

Financial reporting assertions addressed by the XYZ testing included accuracy, completeness, existence and valuation of tax balances. Key controls tested by XYZ included:

- Quarterly balancing between general ledger and Tax Provision Spreadsheets (GAAP)
- Reconciliation between the tax provisions and the filed tax return (GAAP and STAT)
- Tax provision calculations are reviewed by Tax Management (GAAP and STAT)
- Validation of temporary differences (GAAP and STAT)
- Reasonableness test on permanent differences (GAAP and STAT)
- FIN 48 Reserve items are evaluated and reserve adequacy is analyzed (GAAP & STAT)

Controls were found to be designed and operating effectively as of 12/31/13.

Substantive Procedures Included:

- Testing of Permanent & Temporary Differences

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