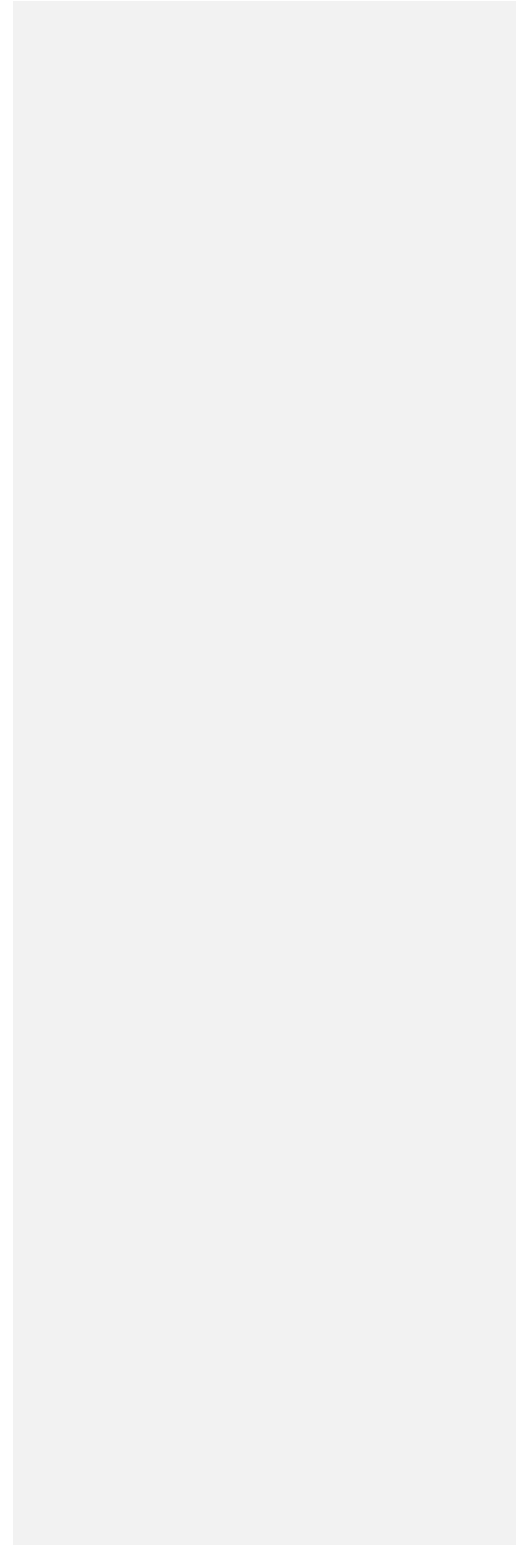


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Sound Practices in Conducting C-Level Interviews:

**Apply**

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, attempt to interview the Chief Risk Officer early in the process, as this position typically has a broad awareness of the company's risk exposures

Customize interview questions based on understanding of company's risks and recent trends and continue to customize subsequent interviews as new information is learned

[Provide a list of general topics to be covered to the interviewee ahead of the session, to help them prepare for the discussion](#)

Limit the number of in-person exam team representatives involved in each interview to encourage more candor in conversations and preserve budget

- Encourage other team members to suggest topics/questions ahead of time and review notes after the fact to understand results

Sound Practices in Overall Corporate Governance Assessment:

**Apply**

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
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**Phase 2 – Identify and Assess Inherent Risk in Activities**

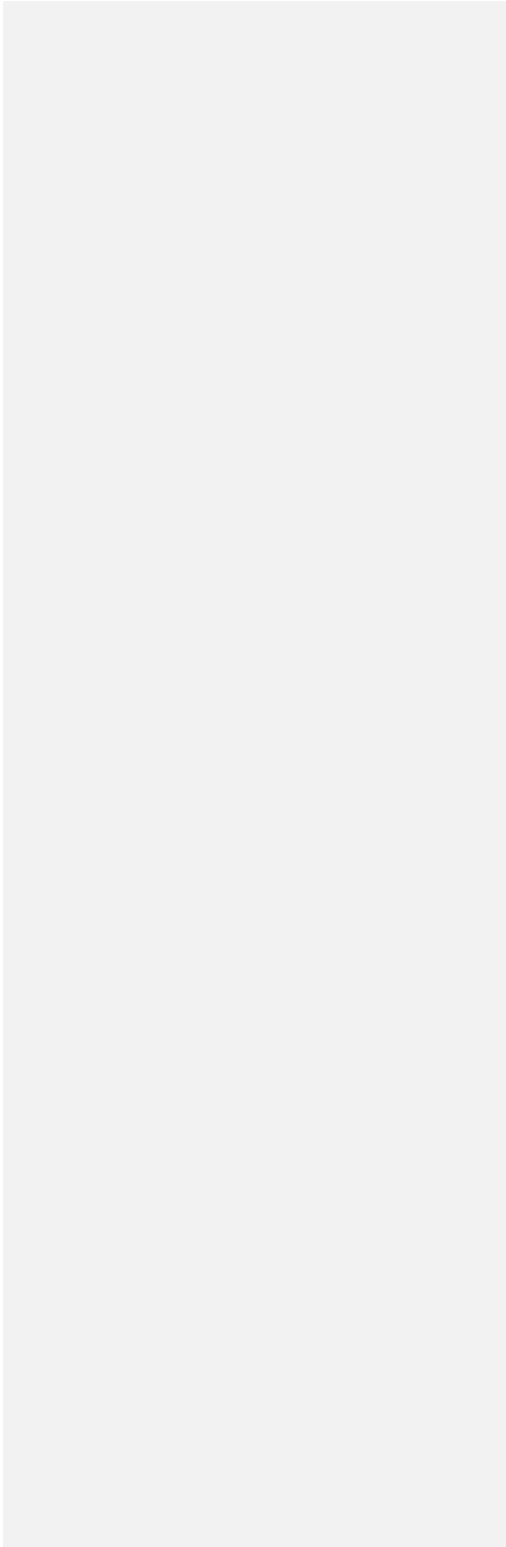
Phase 2 requires the examiner to identify specific risks within the key functional activities, including business and prospective risks. The examiner should consider potential events that, if they occur, may affect the entity when determining risks.

**Effective Use of Exhibit CC – Risk Tracking Template:**

**Apply**

- Post unique risks identified during the exam planning process to Exhibit CC for tracking and follow-up
- Clearly document the source of risks posted to Exhibit CC to demonstrate that input was received through a wide range of sources
- Ensure that input from the financial analyst is clearly referenced
  - Consider posting all IPS risk components above a certain

Writing Effective Risk Statements:

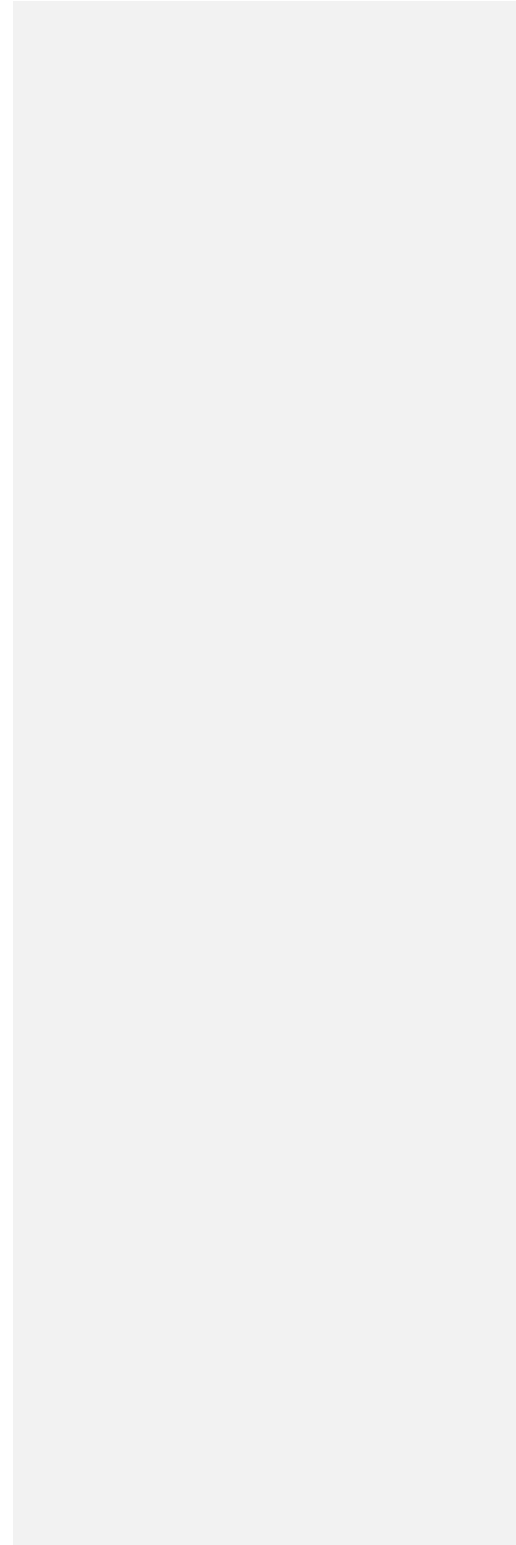


**Phase 3 – Identify and Evaluate Risk Mitigation Strategies**

Phase 3 requires the identification and evaluation of the insurer’s risk mitigation strategies/controls that are in place to mitigate the inherent risks identified in Phase 2. The exam team should focus on identifying and understanding controls/strategies that the insurer has in place and consider whether they appear to be designed appropriately to mitigate risk. If so, the exam team should test the controls/strategies for operating effectiveness and conclude on whether they effectively mitigate the inherent risks identified.



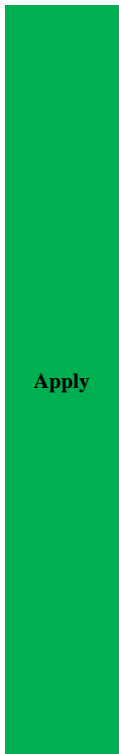
Sound Practices for Risk-Focused Financial Examinations



**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 communicate key findings and recommendations to the assigned financial analyst.

**Summary Review Memorandum Best Practices:**



Use the SRM to provide concise branded risk narrative, risk trend, and risk assessment updates to the analyst based on exam results

- Most exams are expected to result in some new information that can be communicated to supplement the existing narrative discussion of branded risks in the IPS
- See examples in Exhibit AA of the Handbook

**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:

<b>Apply</b>	<p>Ensure that findings and recommendations listed in the report relate to findings of fact</p> <p>For coordinated examinations, consider the multi-entity report format if the examination includes multiple legal entities domiciled in the same state</p> <ul style="list-style-type: none"> <li>○ If using multi-entity report format, ensure that required information is addressed for each legal entity included in the report</li> </ul> <p>For coordinated examinations, consider a group exam report, when appropriate</p>
<b>Avoid</b>	<p>Taking responsibility for or opining on the financial statements in the exam report</p> <p>Including information that may be considered subjective or proprietary</p>

Management Letter Sound Practices:

<b>Apply</b>	<p>Ensure issues identified through testing are communicated to the company (e.g., via management letter or exit conference)</p> <p>Based on the issues identified, consider the level at which the management letter should be provided (i.e., legal entity level, parent company level, etc.)</p> <ul style="list-style-type: none"> <li>○ Consider significance and severity of findings (or for financial reporting matters whether they represent “material weakness” or “significant deficiency”), as well as ability to take corrective action to assist in determining the appropriate level</li> <li>○ In some circumstances, two separate management letters may be appropriate</li> </ul> <p>Ensure findings in the management letter are also communicated to the analyst and other regulators, as appropriate</p> <ul style="list-style-type: none"> <li>○ Utilize the Financial Examination Electronic Tracking System (FEETS) to share management letter with other states</li> </ul> <p>Coordinate with the analyst to obtain company responses in a timely manner, as appropriate</p> <ul style="list-style-type: none"> <li>○ <a href="#">Involve specialists and other internal stakeholders in reviewing and evaluating</a></li> </ul>
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**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>	<p>Identify and investigate prospective risks throughout the first 5 phases of the exam</p> <p>Perform independent testing when appropriate but recognize that a review of prospective risks will often focus on the insurer’s ability to manage them</p> <p>Recognize the significance of prospective risks facing the company and ensure that investigation and testing of these risks is prioritized</p> <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> <p>Share results of the prospective risk assessment with the department analyst</p>
<b>Avoid</b>	<p>Identifying overly broad or obscure risks that don’t clearly indicate the risk to the company</p> <p>Limiting assessment of prospective risks to phases 1-2</p> <p>Documenting the assessment of a prospective risk on Exhibit V and in a Key Activity, without clarifying how the risks interrelate</p> <p>Relying on management assertions or future plans to address a risk, without obtaining corroborating support</p> <p>Passing a prospective risk back to the analyst without gathering additional information to assist the analyst in ongoing monitoring</p>

**Sound Practices in the Selection, Use and Oversight of Contractors:**

<b>Apply</b>	<p>Establish guidelines for the selection of a firm and individual contractors to ensure they are appropriate/sufficient for the exam. Consider a formal request and approval process for the firm and any subcontractors selected for the exam</p> <ul style="list-style-type: none"> <li>○ Require notification if an essential contractor initially selected becomes unavailable to perform the examination</li> </ul> <p>Provide access to relev</p>
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	<p>When using contractors in a coordinated examination, it may require increased oversight by the department designee to ensure contractors are efficiently utilizing and relying upon the work of other states and contractors when appropriate. Refer to the Coordination FAQ on page 12 of this document for further information on using contractors in coordinated examinations.</p>
<b>Avoid</b>	<p>Utilizing more contractors than can be adequately trained, monitored and supervised                  Using multiple contract examination firms on a coordinated group if possible                  Assigning too many concurrent projects to one department designee</p>

Supervisory Review Sound Practices:

<b>Apply</b>	<p>Challenge inherent risk assessment when areas that generally have high risks (e.g., reserving) do not have any “high” inherent risks identified                  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                  When the same procedure or control is linked to multiple risks, challenge if the risk statements are too repetitive or broad, or if the test is truly applicable to the risk                  Consider whether risks have been customized and if not, challenge whether standard repository risks and controls are appropriate or if additional customization is needed                  Ensure there has been proper communication with all departments and any specialist utilized on the examination to verify all risks have properly identified and assessed</p>
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- If current year workpapers are not yet available, consider obtaining prior year workpapers, and discuss any changes between from the prior year's audit approach to the current year audit approach
- Obtain current year workpapers prior to finalizing exam to ensure any issues identified are appropriately considered

Perform a high-level review of the audit function in phase 1, focusing on gaining an understanding of the auditor's scope and level of testing, as well as overall competency

- Intended to enhance exam efficiency, therefore review should be high-level and focused on the ability to rely on work to reduce a review of financial reporting risks during the exam

Rationale supporting planned reliance on audit work to reduce review of financial reporting risks should be adequately supported

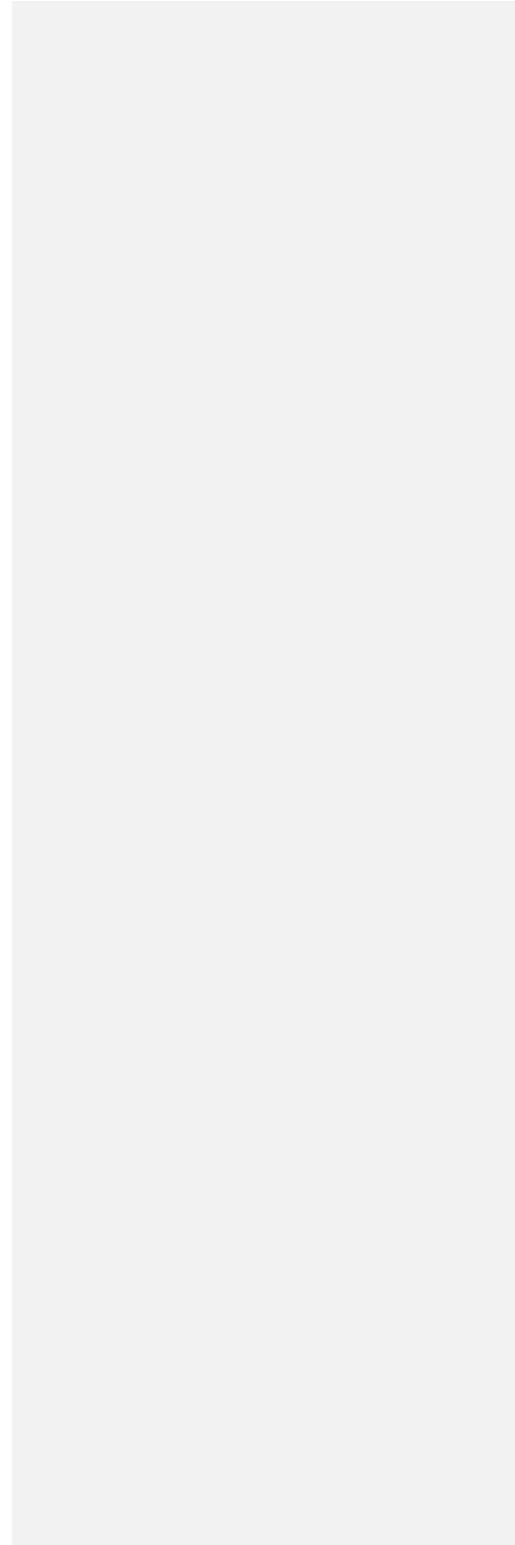
- Documentation can vary and may include a brief summary of audit work performed and key areas of testing or provide more robust explanation, including specific key risks (see example reliance memos at Appendix A below)
- For financial reporting risks addressing a critical risk category or representing a significant concern, audit work can be leveraged, but must be included in the file and properly reference

Ensure approach described in the reliance memo is implemented (i.e., if the exam will rely on audit work to reduce review of financial reporting risks, fewer financial reporting risks should be identified)

Utilize relevant audit work to address identified risks in phases 3 and 5 – bring the audit work into the exam file, review in detail and document a clear conclusion on the work performed

- If errors or issues are noted in conducting a detailed review of specific audit workpapers in phases 3 or 5, avoid placing reliance on the work without addressing concerns and instead move to independent testing (as needed)
- If errors or issues noted in conducting a detailed review of audit workpaper

Sound Practices for Risk-Focused Financial Examinations



**Appendix**

**Appendix A – Example Reliance Memos**

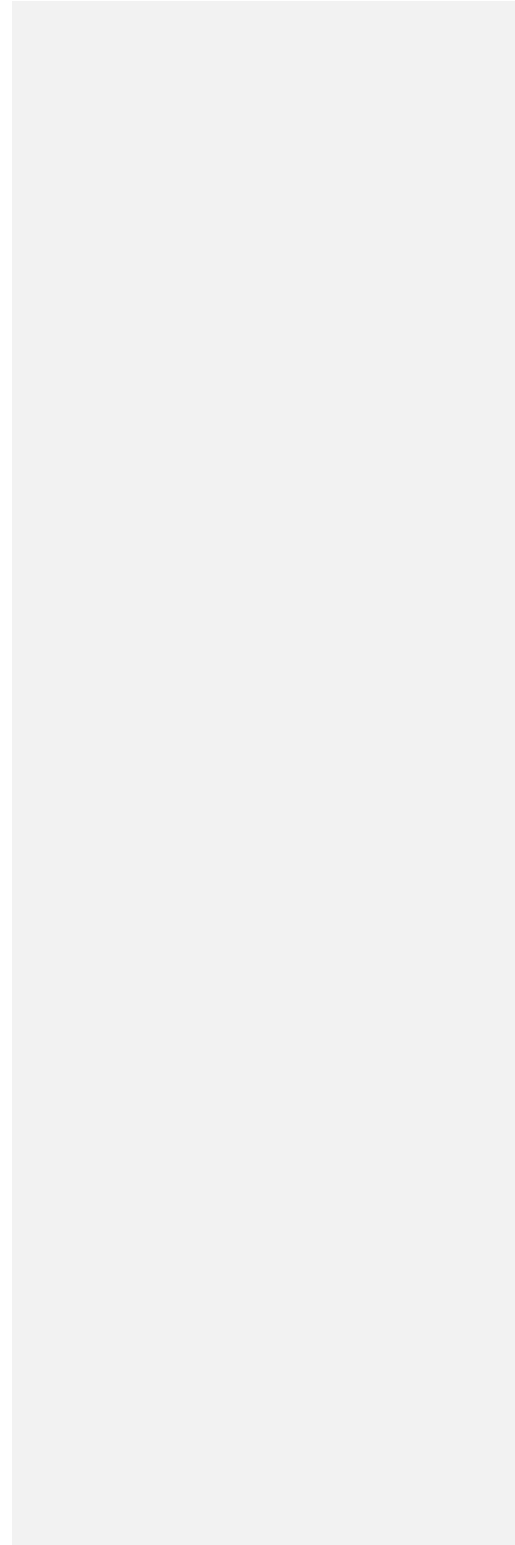
This appendix provides examples of CPA Reliance Memos taken from actual risk-focused examination files submitted for peer review and cited for demonstrating some of the sound practices outlined above. Users are not expected to copy or replicate the work performed, but to re



Testing strategy was designed based on an 'effective/support' evaluation of ITGCs.  
Perform audit of internal control over financial reporting in accordance with PCAOB Auditing Standard No. 5.  
Independent testing of controls over estimation transactions that are generally complex in nature.  
Substantive testing on significant account balances.  
Analyze the investment portfolio for the existence of impaired investments and validate the fair values reported.

- The process followed to assess investment portfolio holdings for potential other-than-temporary impairt 1

Sound Practices for Risk-Focused Financial Examinations



in other areas are referenced to the respective workpaper(s). For all operating expense accounts/mappings that were not tested elsewhere that met the scope above, ABC obtained the GL and judgmentally selected a sample of 6 entries to test. ABC tested each transaction for evidence of management override, proper classification, and proper period recording. ABC notes all entries hitting the accounts outside of expectations were manual journal entries. ABC reviewed the transaction to ensure there was a separate preparer and approver. ABC also reviewed support for the entries, noting the support tied to the entry amounts and seemed reasonable. No exceptions noted.

Work performed by ABC appears to be adequate related to expense accounts as of 12/31/2013 and may be relied upon to reduce financial reporting risks.

**Taxes**

ABC performed an overall review of XYZ's tax provision and footnote disclosures for the year ending 12/31/2013. Supporting documents were reviewed and ABC recalculated the deferred tax asset for each entity. Per ABC's review, all tax balances were deemed reasonable for the period ending 12/31/2013.

ABC obtained the schedule of premium tax accruals broken out by state. ABC prepared an analytic for the accrual based on the total premiums written in the year multiplied by the weighted average tax rate for the prior year. Per MCAP 450, ABC selected six payments for testing, as the balance of the payments is less than 2x PM, or \$8,050,000. For the six payments selected, ABC obtained a copy of the payment and

Appendix A: Example #3

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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
- Testing Recoverability of Deferred Tax Assets
- FIN 48 Testing - Accruals for uncertain income tax positions
- Assessing adequacy of Tax Accruals
- Payments and Refund testing

No findings or other observations were identified as a result of XYZ's substantive procedures.