



25th September 2013

NOTICE

Guidance Note

Role of the Approved Auditor

1. The Bermuda Monetary Authority (the Authority) revised Guidance Note on the Role of the Approved Auditor replaces the two previous Guidance Notes issued in March 2005: “Role of the Approved Auditor” and “Fit and Proper Criteria and Approval Process for the Approved Auditor”.
2. The revised consolidated Guidance Note was needed to reflect subsequent changes to the Insurance Act 1978 (“the Act”) and the Authority’s current procedures. The legislative changes are as follows:
 - a. Subsections 16A(1)(e) of the Act introduces a requirement for the approved auditor, of an insurer or insurance group, to provide the Authority with written notice where “he becomes aware of any fact or matter which is likely to be of material significance for the discharge, in relation to the insurer, of the Authority’s functions under the Act. Subsection 16(6) extends this provision to the approved auditor of the insurance group.
 - b. Subsection 16 (1A) of the Act requires that “a designated insurer shall ensure that the group of which it is a member appoints an auditor approved by the Authority under this section to audit the financial statements of the group.” The revised Guidance Note addresses the role of the approved auditor for the insurance group.
3. The Authority welcomes any comments from industry stakeholders and interested parties. Comments should be sent to policy@bma.bm by 25th October 2013.
4. The revised Guidance Notes will become effective as of 31st December 2014.



BERMUDA MONETARY AUTHORITY

GUIDANCE NOTES

ROLE OF THE APPROVED AUDITOR

September 2013

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I. INTRODUCTION

1. This Guidance Note describes the role of the approved auditor for Bermuda registered insurance businesses and groups, in relation to the Insurance Act 1978, as amended (the “Act”), and the Regulations¹ and Rules² promulgated thereunder, and sets out some of the expectations and responsibilities with respect to that role. This note also provides guidance on the approval process and sets out the criteria upon which the Bermuda Monetary Authority (the Authority) will assess its approval.
2. The Authority recognises the need for clarity as to the scope and implementation of the provisions of the Act, if the regulatory system is to command the confidence of registered insurers,³ insurance groups,⁴ and policyholders. It seeks, therefore, to ensure that insurers, insurance groups and their auditors have a good understanding of the nature of the legislative requirements and of the Authority’s approach in implementing and ensuring compliance with the Act.
3. The approved auditor, as defined under section 16 of the Act, is integral to the Bermuda insurance supervisory model. The primary role of the approved auditor of an insurer is to express an independent and objective opinion as to whether the statutory financial statements are free of material misstatements, and whether the statutory financial returns comply with criteria established in the Act. In the case of the approved auditor of an insurance group, his role is to express an independent and objective opinion on the group consolidated financial statements prepared in accordance with Generally Accepted Accounting Principles⁵ (GAAP) or International Financial Reporting Standards (IFRS).

¹ “Regulations” refer to the Insurance Accounts Regulations 1980, as amended, and the Insurance Returns and Solvency Regulations 1980, as amended.

² “Rules” refers to the Insurance (Group Supervision) Rules 2011, as amended.

³ “Registered insurer” refers to an insurer or reinsurer registered by the Authority, under section 4 of the Act, to carry on insurance business in or from within Bermuda; hereupon, in this Guidance Note, to be referred to as “insurer.”

⁴ “Insurance group” refers to an insurance group for which the Authority is acting as the group supervisor and includes a Bermuda group. Hereupon, in this Guidance Note, “insurance group” will be referred to as “group.”

⁵ Section 23 of the Rules permits group financial statements to be prepared in accordance with GAAP applicable in Bermuda, Canada, the United Kingdom, the United States of America, or such other GAAP, or international standards as the Authority may recognise.

4. The Authority, through this Guidance Note (Guidance), hereby sets out its understanding of the legal provisions affecting the role of the approved auditor, and provides additional information about the Authority's regulatory approach and expectations regarding these matters. The legislative summary in this paper is not intended to be a substitute for the provisions of the Act. For that reason, the reader is advised to refer to the provisions of the Act and not to rely solely on the interpretations contained in this Guidance.
5. The Authority's guidance is of general application and seeks to take account of the wide diversity of insurers and groups that are covered under the Act, Regulations, and Rules. Its application will depend on the nature, scale, and complexity of a particular insurer or group.
6. Guidance should be understood as reflecting the minimum standard that the Authority expects insurers, designated insurers,⁶ and approved auditors to observe at all times. In relation to information contained within this Guidance, the Authority encourages readers to seek further clarification from the Authority when in doubt, to ensure complete compliance with the Act, Regulations, and Rules.
7. From time to time there may be a need for revision to this Guidance. If this does occur, any material changes in the Guidance will be published, generally through the issue of a revised version.

II. APPLICATION

8. This Guidance is applicable to insurers, designated insurers, and auditors approved by the Authority as the approved auditor of an insurer or group.

III. APPOINTMENT OF APPROVED AUDITOR

Legal Entity Level

⁶ "Designated insurer" refers to the designated insurer in relation to group supervision, under section 27B of the Act, and in respect of the group of which it is a member.

9. In accordance with subsection 16(1) of the Act, every insurer must appoint an auditor⁷ approved by the Authority to audit its statutory financial statements.
10. While the auditor may be the same natural person or firm of accountants appointed by the shareholders under section 89 of the Companies Act 1981, under section 16 of the Act, the insurer must still obtain the Authority's approval of the appointment.
11. If an insurer fails to appoint an approved auditor, or at any time fails to fill a vacancy for an approved auditor, under subsection 16(7) of the Act, the Authority may appoint an approved auditor for the insurer and fix the remuneration to be paid by that insurer, if not previously agreed by the insurer and the auditor, within fourteen days.

Group Level

12. Under subsection 16(1A) of the Act, a designated insurer must ensure that the group, of which it is a member, appoints an auditor approved by the Authority to audit the general purpose GAAP or IFRS financial statements of the group.

IV. NOTIFICATION PRIOR TO REGISTRATION OR DETERMINATION

Legal Entity Level

13. Prior to registration the insurer is required to notify the Authority, in writing, of its proposed approved auditor. 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 document (Form 1 B), with an accompanying letter from the auditor to the insurer provisionally accepting their proposed engagement as approved auditor for the purposes of the Act.
14. If there is any change in the information provided in the notice, referred to in paragraph 13 above, regarding the proposed auditor, the insurer is required, under

⁷ "Auditor" as defined in the Act, means either (a) a person entitled to practice as a public accountant in Bermuda; or (b) a person who has qualified as an accountant by examination of one of the Institutes of Chartered Accountants of England and Wales, Ireland and Scotland or the Canadian Institute of Chartered Accountants or the American Institute of Certified Public Accountants; or (c) a person recognised by the Authority as an auditor.

section 8 of the Act, to provide written notice to the Authority within fourteen days of the change.

Group Level

15. Where the Authority makes a determination, under section 27B of the Act, to act as the group supervisor of a group, the group's auditor will be assessed for approval by the Authority.

V. CRITERIA FOR APPROVAL

16. Prior to approving a natural person or firm of accountants for the role of the approved auditor for an insurer or group, the Authority will generally assess the proposed auditor using the following criteria:

- a. Fit and proper to fulfill the role; and
- b. Independent of the insurer or group.

Fitness and Propriety

17. The auditor is deemed to be a fit person to perform the role of the approved auditor where its qualifications, experience, resources and skills are commensurate with the nature, scale, and complexity of the insurer or group's business.

18. The auditor is deemed to be a proper person to perform the role of the approved auditor where that person is of high integrity. In assessing integrity the Authority takes into consideration:

- a. Whether the person has contravened any provision of law designed to protect members of the public against financial loss;
- b. Whether the person has been involved in any deceitful or improper business practices; and
- c. Whether the person has been censured or disqualified by a relevant professional or regulatory body.

19. In the case of an auditor of a Bermuda registered insurer, a person will generally be considered a fit and proper person if the person is ordinarily resident in Bermuda and a

member in good standing with the Institute of Chartered Accountants of Bermuda (ICAB).

20. The general fitness and propriety criteria listed above notwithstanding, in the case of a group auditor, a person will generally be considered fit and proper if the person is a member in good standing with ICAB, or an auditor (as defined in the Act – see footnote 7 of this document) in good standing.

Independence

21. An auditor must be independent of the insurer or group for which he has been appointed the approved auditor. Under subsection 16(6) the Act, no person having an interest in any insurer or designated insurer other than that of an insured, and no officer, servant, or agent of any insurer, would be eligible for appointment as an approved auditor for that insurer or group. Furthermore, any person appointed as an approved auditor to any insurer or group who subsequently acquires such interest or becomes an officer, servant, or agent of that insurer would cease to be an approved auditor.
22. In interpreting the requirements of subsection 16(6) the Authority would look to the definition of independence within the meaning of the Rules of Professional Conduct of ICAB, which determines the auditor's independence in terms of the Auditor's objectivity. The rules provide that members of ICAB who perform assurance or specified auditing procedures engagements shall be and remain free of any influence, interest or relationship, in respect of the client's affairs, which impairs the member's professional judgment or objectivity or which, in the view of a reasonable observer, would impair the member's professional judgment or objectivity.
23. An insurer or designated insurer should provide information, in accordance with the reasonable requests of the Authority, to demonstrate that its candidate for approved auditor is independent and/or meets the eligibility and fit and proper criteria, or in the case of an incumbent approved auditor, that the approved auditor continues to be independent and to meet the eligibility and fit and proper criteria.

VI. CONFIRMATION OF APPROVAL

24. If the proposed auditor is approved, the Authority will provide written confirmation of its approval to the insurer or designated insurer.

VII.ACCEPTANCE OF AN ENGAGEMENT

25. Prior to accepting an appointment as the approved auditor, the Authority expects the auditor to be satisfied that the scale and complexity of the insurer or group, and the examination of the insurer or group pursuant to the Act is within the collective professional expertise and proficiency of the auditor and other persons performing the engagement.

VIII.DISQUALIFICATION

26. Approval of an auditor for an insurer or group may be revoked, if the Authority is satisfied that the approved auditor appointed is no longer a fit and proper person to fulfil the role.

27. The Authority shall not revoke its approval of an auditor without first notifying the appointed approved auditor and the insurer or designated insurer of its intention to do so.

28. If at any time an insurer or a designated insurer becomes aware that the approved auditor of the insurer or group is not independent, or no longer meets the fit and proper criteria, the insurer or the designated insurer must take timely steps to ensure that an independent, fit and proper auditor is appointed.

IX. CHANGE IN APPROVED AUDITOR

29. Where there is to be a change in the approved auditor, the insurer or designated insurer must obtain prior approval from the Authority before appointing a new approved auditor.

30. If an insurer or designated 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 or designated insurer shall give written notice to the Authority.
31. The approved auditor of an insurer or group must give written notice to the Authority if he resigns before the expiration of his term in office, or becomes aware that he will be replaced, or he intends not to seek to be reappointed.
32. Before the Authority will approve the appointment of a new auditor for an insurer or group, as part of the approval process the Authority will require a written explanation from the insurer or designated insurer for the change in the approved auditor and, where applicable, written explanation from the previous approved auditor of the reasons for the cessation of his appointment.

X. RIGHT TO INFORMATION

33. The Authority expects that an insurer, or designated insurer of a group, will make the necessary arrangements to enable the approved auditor to perform his 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 licence or any directions given by the Authority under section 56 of the Act (accounting modification provisions). In addition, the insurer or designated insurer should ensure that its approved auditor has access to all relevant data and people that it reasonably believes are 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 or designated insurer should ensure that any suppliers under a material outsourcing arrangement (e.g. claims management, information technology support) give the approved auditor the same rights of access.

XI. AUDITOR'S EXAMINATION

34. The Authority expects the approved auditor to conduct its audit in accordance with generally accepted auditing standards (GAAS) for Canada, the United Kingdom, the United States of America or such GAAS as the Authority may recognise.

XII. 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 or group, in accordance with the Act, the Authority expects this reliance to be in compliance with GAAS.

XIII. AUDIT REQUIREMENT – LEGAL ENTITY

Requirement for Audited Statutory Financial Statements

36. Pursuant to section 15 of the Act, an insurer must prepare statutory financial statements for each financial year that are audited by the approved auditor, unless the insurer has obtained an exemption from the Authority.

Requirement for Statutory Financial Returns

37. Every insurer is required to file a statutory financial return at the time it files its statutory financial statements with the Authority.

Approved Auditor's Report

38. The approved auditor is to prepare an auditor's report to be included with the statutory financial return filed by the insurer.⁸ The report is to be in the form prescribed in section 7 of the Insurance Returns and Solvency Regulations 1980 (IRASR), and is to be signed by the approved auditor and addressed to the Authority.

39. In its report the approved auditor is required to confirm that he has carried out an examination of the insurer's statutory financial statements in accordance with

⁸ Insurance Returns and Solvency Regulations 1980 7(1)(a) currently provides that report is to be prepared in accordance with accepted auditing standards.

GAAS. The report should state the applicable jurisdiction for the GAAS applied.

40. The approved auditor is further required to express an opinion on the following:

- a. Whether the statutory financial statements have been prepared in accordance with the requirements of the Act and applicable regulations insofar as such provisions relate to accounting and financial reporting matters;
- b. Whether the Solvency Certificate and Declaration of Statutory Ratios comply, with the criteria of the IRASR; and
- c. 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.

41. If the following events were to occur in relation to the audit, an auditor is to qualify his report and include his observations, whether of fact or opinion, as he considers necessary, for bringing the nature and effect of the qualification to the attention of the Authority. The events are as follows:

- 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.

XIV. AUDIT REQUIREMENT – GROUP LEVEL

42. Under paragraph 23 of the Rules, every group must prepare consolidated financial statements for each financial year that are audited by the group's approved auditor and an auditor's report prepared by the group's approved auditor in accordance with GAAS for Canada, the United Kingdom, the United States of America or such GAAS as the Authority may recognise.

XV. COMMUNICATION OF CERTAIN MATTERS WITH THE AUTHORITY

43. When an approved auditor makes a material modification of his report on an insurer's statutory financial statements and in particular, a material qualification or a denial of his opinion, or a statement of adverse opinion, the approved auditor of the insurer must give written notice to the Authority and provide the Authority with a copy of the report as soon as possible.

44. Under subsection 16A(1)(e) of the Act, an approved auditor must give written notice to the Authority if he becomes aware of any fact or matter which is likely to be of material significance for the discharge, in relation to the insurer or group, of the Authority's functions under the Act. In the context of an audit such facts or matters may include, but are not limited to, where the auditor of a group or insurer:

- a. Identifies a material misstatement in the insurer's statutory financial statements or group financial statements resulting from fraud, error or illegal acts or the consequences of them; or
- b. Concludes that there is substantial doubt as to the ability of the insurer to continue as a going concern for a period of one year from the balance sheet date; or
- c. Identifies adjustments to the group financial statements, which individually or in aggregate, indicates to him that the previous year's audited annual financial statements, prepared according to GAAP, were materially misstated; or
- d. Identifies adjustments to the insurer's financial statements, which individually or in aggregate, indicates to him that the previous year's audited annual financial

statements, were materially misstated; or

- e. Identifies a material weakness⁹ in internal control during the conduct of normal audit procedures; or
 - f. Has unresolved disagreements with management pertaining to the application of GAAP or statutory reporting.
45. Under section 16A of the Act, no duty to which an approved auditor of an insurer or group 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 Act. This applies to any matter of which an approved auditor of an insurer or group becomes aware in his capacity as auditor and which relates to the business or affairs of the group or insurer or any affiliate of the insurer.

XVI. ACCESS TO INFORMATION AND REPORTS

46. The Authority, using the powers under section 29A of the Act, will conduct routine prudential meetings and visits with insurers or designated insurers. In order to verify information for regulatory purposes, the Authority may send a letter to the approved auditor of the insurer or group 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 or designated insurer to confirm that the insurer understands his obligation to cooperate with the Authority and to seek permission to provide access to the auditor's working papers. The approved auditor should send the signed cooperation letter back to the Authority.

⁹ A material weakness in internal control is defined as a deficiency, in which the design or operation of one or more of the internal control components of the insurer or group, does not reduce to a relatively low level, the risk that misstatements caused by error, or fraud, in amounts that would be material, in relation to the financial statements being audited may occur, and fail to be detected, within a timely period by employees in the normal course of performing their assigned functions.