NAIC NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

# General Sound Practices for Risk-Focused Financial Examinations

(Updated June 2025)

The sound practices presented in this document attempt to outline helpful hints and effective practices to **Apply**, as well as problematic practices to **Avoid** when performing risk-focused financial examinations. These practices have been accumulated as a result of the NAIC Peer Review Programs, and feedback from states and the NAIC accreditation team in implementing risk-focused examinations. The sound practices are presented relevant to the seven phases of a financial examination.

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

In Phase 1 of a risk-focused examination, key functional activities (KFAs) are identified using background information gathered on the company from various sources. In addition, the insurer's corporate governance processes and practices are evaluated and assessed.

Sound Practices in Coordination with Financial Analysis:

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| **Apply** | • Review the latest IPS and other key documents shared by the financial analyst prior to participating in a planning meeting. Focus document review on the most recent year-end of the examination period.<br>• Meet in-person or via virtual meeting (email alone is not sufficient) at the start of the exam to discuss company operations, trends and risks/concerns identified by analyst<br>  o Utilize Exhibit D – Planning Meeting with Financial Analyst to set agenda and identify discussion topics<br>  o Identify specific validation/verification or test procedures to be conducted during exam, as recommended by analyst<br>• Utilize analyst input to drive risk identification/exam scoping and to reduce the extent of other exam planning procedures, as appropriate<br>  o Request additional information as necessary (i.e., detailed analysis, tool results, correspondence) to understand Significant/Moderate risk exposures and historical analysis performed<br>• Clearly document risks/concerns communicated by analysis on Exhibit CC and ensure they are adequately addressed during the exam<br>  o As a rule of thumb, consider placing all Significant/Moderate IPS risk components on Exhibit CC<br>  o If there are disagreements regarding the importance of risks/concerns, discuss them up front to reach consensus<br>• Continue to communicate with the analyst throughout the exam by sharing status reports, setting up ad-hoc meetings (as necessary), receiving updates on latest analysis work (i.e., quarterly results, supplemental filings, HC analysis, etc.)<br>  o Consider including a correspondence folder in the exam file to document the nature and extent of communications |
| **Avoid** | • Duplicating analysis work by conducting widespread reviews of company filings and extensive exam planning analytics<br>• Allowing the analyst to provide only limited input on risks/concerns and the direction and scope of the examination<br>  o It should be rare for the exam team to come out of the planning meeting with the analyst with no specific risks identified<br>• Discounting the risks/concerns identified by the analyst and not clearly incorporating them into the scope of the exam |

Sound Practices in Conducting C-Level Interviews:

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| **Apply** | • Meet with the department analyst prior to scheduling interviews to adequately transfer regulatory insights gained during the period between examinations<br>  o Consider inviting the primary analyst involved with the company to participate in the C-Level interviews<br>• 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 |

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| | • Customize interview questions based on understanding of company's risks and recent trends and continue to customize subsequent interviews as new information is learned<br>• Provide a list of general topics to be covered to the interviewee ahead of the session, to help them prepare for the discussion<br>• Limit the number of in-person exam team representatives involved in each interview to encourage more candor in conversations and preserve budget<br>  o Encourage other team members to suggest topics/questions ahead of time and review notes after the fact to understand results<br>• Carefully consider the appropriateness of allowing other insurance company staff (including legal) to sit in on interviews<br>  o If allowing, consider whether others should be dismissed for a portion of the interview to ensure effective information exchange<br>  o Also, consider limiting the role of legal in the interviews to note taking and discourage them from speaking extensively<br>• When interviews are conducted virtually, utilize video conferencing capabilities to the extent possible<br>  o Encourage all company staff participating in the interview to be visible on camera<br>• Summarize key discussion items and points in exam notes, highlighting identified risks that will be posted to Exhibit CC<br>• Conclude on whether there are any suitability concerns in each set of interview notes |
| **Avoid** | • Asking all questions from Exhibit Y templates without customization<br>• Providing a specific list of questions to be covered to the interviewee, as this could reduce the level of candor in the conversation and potentially limit the scope of the interview or follow-up questions<br>• Exhausting exam budget and putting the interviewee on alert by having 10+ examiners/analysts involved in each coordinated exam interview<br>• Typing full transcripts of interview notes, which can be burdensome to produce and review |

Sound Practices in Overall Corporate Governance Assessment:

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| **Apply** | • Leverage the Corporate Governance Annual Disclosure (CGAD) filing and related analysis documentation as a starting point for assessment<br>  o Consider validating the information covered in the CGAD on a test basis, particularly if requested by the analyst<br>  o Highlight any inconsistencies or key information missing from the CGAD in the SRM for communication back to analysis<br>• Focus review of board and committee minutes on the most recent year-end of the examination period and areas of greater concern or heightened risk, as well as key committees.<br>• Carry forward any relevant risks identified as a result of the review to Exhibit CC<br>• If utilizing a customized corporate governance rating tool, provide adequate narrative support for assessed ratings<br>• Provide a clear conclusion regarding the effectiveness/appropriateness of the corporate governance function<br>  o If significant concerns are identified, consider the impact on the examination, including the ability to place reliance on certain controls and/or whether adjustments to the company's priority rating are warranted |



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| | • Communicate significant concerns to the department analyst and/or the company via the management letter |
| **Avoid** | • Recording details of every board and committee meeting for all years under examination<br>• Documenting a vague conclusion (e.g., corporate governance is "moderate" or rating of "X") without further explanation as to the impact on the examination |

Sound Practices in Integrating the IT Review into the Financial Exam:

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| **Apply** | • Consider requesting access to CPA IT audit workpapers ahead of the other audit workpapers to ensure that IT review can be completed timely<br>• Leverage work performed by others (e.g., internal or external audit, other regulatory agencies, third-party specialists, cybersecurity experts, etc.)<br>  ○ IT examiner should document planned reliance on such work within the IT planning memo but need not map that work to the relevant sections of the IT Work Program if the work fully addresses IT risks.<br>  ▪ However, if the audit work only partially addresses IT risks, then the work should be mapped to the respective risk(s) in the IT work program to supplement any additional testing performed<br>  ○ When placing reliance on work of others, ensure IT exam objectives are addressed by the work performed and consider retesting a sample of such work, when appropriate<br>• If IT Review is running behind, consider documenting a preliminary IT review conclusion and proceeding with exam fieldwork<br>  ○ If significant IT review findings are subsequently identified, clearly document how exam work was modified to address<br>• Customize the IT review, including risks placed on Exhibit C, based on the size and complexity of the company under examination<br>• Leverage IT examiner expertise throughout the exam for IT-related matters (e.g., application control testing, Cybersecurity, etc.), as appropriate<br>• Document a clear conclusion regarding the effectiveness of ITGCs (i.e., "effective", "effective except for", or "ineffective") as well as the impact of findings on the examination (if any) and any related follow-up that may be necessary.<br>• If the IT review must be conducted remotely, the IT examiner should use software with videoconferencing/screen-sharing capabilities.<br>  ○ To maintain the integrity of a virtual review, the examiner should provide specific requests to the company to obtain and inspect all necessary support for the review procedures. |
| **Avoid** | • Performing the entire IT Review without customization<br>• Reaching a conclusion that IT general controls are not reliable without considering whether compensating controls or other mitigating factors are present<br>• Reaching a conclusion that IT general controls are not reliable without clearly documenting how remaining phases of the exam will be adjusted<br>• Documenting vague conclusions that do not clearly indicate the effectiveness of the ITGC environment as it relates to the financial exam (e.g., "moderately effective", "partial reliance", etc.)<br>• Moving ahead with key activity "fieldwork" prior to reaching a conclusion (at least preliminarily) on the effectiveness of IT general controls |

**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:

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| **Apply** | • Post unique risks identified during the exam planning process to Exhibit CC for tracking and follow-up<br>• Clearly document the source of risks posted to Exhibit CC to demonstrate that input was received through a wide range of sources<br>• Ensure that input from the financial analyst is clearly referenced<br>  ○ Consider posting all IPS risk components above a certain threshold (e.g., Moderate/Increasing) to Exhibit CC<br>• Meet with full exam team to discuss risks identified on CC to determine which will be carried forward and addressed through exam procedures<br>  ○ This meeting can also be used to ensure that exam team understands the risks to ensure they are properly addressed<br>• Provide specific references to where/how risks are ultimately addressed |
| **Avoid** | • Posting every risk from the Handbook that might be relevant to Exhibit CC<br>• Including multiple, redundant, and overlapping risks on Exhibit CC without combining or aggregating them before posting to Exhibit V or a risk matrix<br>• Providing generic references to where risks are addressed (i.e., Investments Matrix) |

Effective Use of Exhibit DD – Critical Risk Categories:

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| **Apply** | • Clearly conclude on whether each of the critical risk categories are relevant and applicable to the insurer/group being examined<br>• Consider prospective nature of risks (i.e., not a current risk for the company, but has potential to be in the future)<br>• Document specific references to the risks intended to address the critical risk category<br>• If categories are not deemed relevant, provide rationale as to why the insurer/group is not exposed to that risk<br>  ○ Carry rationale/explanation forward to the Exam Planning Memo |
| **Avoid** | • Relying on existence of controls or CPA work to explain away a critical risk category<br>• Explaining away too many critical risk categories, as companies are generally exposed to risk in most of the categories |

Writing Effective Risk Statements:

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| **Apply** | • Draft specific risk statements that form a complete sentence and are testable<br>• Leverage company risk statements from ERM processes when deemed relevant and effective<br>• Discuss key risk statements with the financial analyst or exam specialists as needed to ensure that they are clear and consistently understood<br>• Customize risk statements to the unique situations and exposures of each insurer<br>• In conducting a group examination, clarify which entities are covered under which risk statements |

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| **Avoid** | • Relying entirely on example risk statements from Handbook/TeamStores<br>• Writing broad risk statements that may be difficult to address without an extensive number of controls and detail tests<br>  ○ For example, avoid utilizing broad risk statements from company ERM documentation or 10-K filings without adjusting them to meet examination purposes<br>• Drafting risk statements that are the opposite of a common control<br>• Drafting risk statements that overlap with each other and result in the same controls and detail testing being performed in multiple areas<br>• If sharing with the company to collect control information, avoid risk statements that are overly negative to avoid conflict |

## 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 in Risk Mitigation Strategy/Control Identification:

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| **Apply** | • If asking insurer to assist in control/strategy identification, carefully assess whether controls/strategies in response truly address risk<br>• Leverage existing CPA, internal audit, ERM and company control narratives/documentation for control/strategy identification purposes<br>  ○ If the exam team creates separate process memos, keep them concise and focused on information needed to identify risks and scope examination activities<br>• Focus on key controls that provide primary mitigation to achieve efficiencies in documentation and testing<br>• Clearly document how controls relate to different lines of business, entities, and states to ensure that risks are fully addressed<br>• Document a high-level understanding of controls in place, even if the company does not have a formally documented process |
| **Avoid** | • Identifying a large number of controls that are semi-related to the risk statement but may be inefficient to review and document<br>• Documenting lengthy paragraphs describing general overall control processes or referencing process walkthroughs, without clear identification of which elements are being relied upon to address the risk<br>• Creating extensive control documentation on behalf of the company, such as flowcharts and extensive narratives that aren't necessary to document an understanding of controls |

Sound Practices in Risk Mitigation Strategy/Control Testing:

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| **Apply** | • When relying on multiple controls to address a single risk, document a single overall assessment regarding how the controls collectively address the risk<br>• Leverage existing CPA, internal audit, ERM testing, or other third-party testing, when appropriate.<br>  ○ When placing reliance on work of others, ensure exam objectives are addressed by the work performed and consider retesting a sample of such work, when appropriate |

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| | • Provide clear workpaper documentation, including specific references (e.g., page numbers, elements relied upon, etc.), on supporting workpapers<br>• When relying on Board oversight as a mitigation strategy, review the meeting minutes/board packet to validate the depth of the Board's discussion, understanding and decision making.<br>  o Ensure that the Board is deemed suitable and has the relevant expertise.<br>• When leveraging third-party work, such as external audit work, ensure that test objectives align, and any findings/exceptions are appropriately addressed<br>• Establish an encrypted/secure transfer site for receiving sensitive documentation from the company. |
| **Avoid** | • Documenting an assessment on each individual control tested for a single risk statement instead of providing a conclusion for how the controls collectively address the risk<br>• Relying on information provided within C-Level Interviews without further corroboration or testing<br>• Bypassing phase 3 control testing as a whole and relying only on phase 5 detail testing, without appropriate rationale (i.e., inefficiency, not being able to place much reliance on control testwork, etc.) |

## 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:

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| **Apply** | • 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"). |
| **Avoid** | • Feeling obligated to document a rationale when the calculated residual risk provides an option (e.g., "High or Moderate", "Moderate or Low") |

## 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.

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| **Apply** | • Ensure proper workpaper documentation, including clear references or hyperlinks to test work performed<br>• Ensure sample sizes are appropriate (Consider utilizing Exhibit O)<br>• Ensure nature and extent of testing is commensurate with the residual risk assessment<br>• 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.<br>• When leveraging third-party work, such as external audit work, ensure that test objectives align, and any findings/exceptions are appropriately addressed<br>  o If additional work is necessary to fully understand and evaluate the nature of the work performed when relying extensively on third-party work to address a residual risk, consider retesting a sample of such work |

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| | ○ If test objectives and risk assessments align, it may be appropriate to document reliance on the external audit sampling approach and rationale. In this situation, it is not required to test additional items to achieve handbook sample size recommendations |
| **Avoid** | • Performing detail testing outside of a key activity matrix (other than for compliance testing purposes)<br>• Including reports (e.g., CPA audit report, actuarial opinion, etc.) or general audit programs as supporting documentation without providing specific references to sections within being relied upon to address the risk<br>• Not testing important, material emerging risks due to the fact that they didn't exist as-of the date of the examination<br>○ This includes emerging risks associated with the implementation of new systems, lines of business, strategies, etc. |

## 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:

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| **Apply** | • Use the SRM to provide concise branded risk narrative, risk trend, and risk assessment updates to the analyst based on exam results<br>○ 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<br>○ See examples in Exhibit AA of the Handbook<br>• Ensure that significant new risks identified during the exam, or suggested ongoing monitoring for new or existing risks are communicated to the analyst<br>○ Suggestions should provide new information that would help the analyst better understand the results of operations and set expectations for future<br>○ Information could highlight key individuals, processes and reports to assist the analyst in monitoring exposures on an ongoing basis<br>○ Suggest a timeline for follow-up procedures (when possible), in accordance with risk exposure and ongoing mitigation activities<br>• As a rule of thumb, consider providing additional information and suggested ongoing monitoring procedures for all Significant/Moderate risks<br>○ Even if examiner agrees with the analyst's assessment of risk, provide corroborating evidence obtained during exam, if possible<br>• Ensure that risks identified by the analyst in exam planning and throughout the exam are adequately addressed in the SRM.<br>• Ensure that results of the prospective risk assessment are carried forward to the SRM, as appropriate<br>• Conduct an exit meeting with the analyst to ensure that information to assist the analyst with ongoing monitoring is communicated and understood<br>• If new risks arise during the wrap-up phases of the examination that were not present as of the balance sheet date, the exam team should consider the nature and significance of the risk to determine whether further procedures would be appropriate (e.g., recommending further, specific analyst monitoring on the SRM or conducting a limited-scope examination in the future). |

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| **Avoid** | • Agreeing with the analyst on all risk assessments and trends without providing any new information to assist the analyst in ongoing monitoring<br>• Including extensive exam documentation and testing results in the SRM that make it difficult for the analyst to identify key takeaways<br>  ○ If necessary for higher risk areas, consider summarizing results in SRM and cross referencing to additional detail available in other areas of the exam file<br>• Recommending burdensome ongoing monitoring procedures that aren't likely to identify significant changes in risk exposure<br>• Recommending ongoing monitoring procedures that are redundant with analysts existing responsibilities (i.e., reviewing company filings, monitoring agency ratings) |

## 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:

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| **Apply** | • Ensure that findings and recommendations listed in the report relate to findings of fact<br>• For coordinated examinations, consider the multi-entity report format if the examination includes multiple legal entities domiciled in the same state<br>  ○ If using multi-entity report format, ensure that required information is addressed for each legal entity included in the report<br>• For coordinated examinations, consider a group exam report, when appropriate |
| **Avoid** | • Taking responsibility for or opining on the financial statements in the exam report<br>• Including information that may be considered subjective or proprietary |

Management Letter Sound Practices:

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| **Apply** | • Ensure issues identified through testing are communicated to the company (e.g., via management letter or exit conference)<br>• 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.)<br>  ○ 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<br>  ○ In some circumstances, two separate management letters may be appropriate<br>• Ensure findings in the management letter are also communicated to the analyst and other regulators, as appropriate<br>  ○ Utilize the Financial Examination Electronic Tracking System (FEETS) to share management letter with other states<br>• Coordinate with the analyst to obtain company responses in a timely manner, as appropriate<br>• Involve specialists and other internal stakeholders in reviewing and evaluating the appropriateness of company responses |

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| | • For coordinated examinations, consider a group management letter to communicate relevant findings at the group level |
| **Avoid** | • Stepping into the shoes of management or acting as a consultant by making specific recommendations as to how a concern or issue should be addressed<br>• Placing significant exam findings that represent findings of fact in a ML to avoid including them in a public exam report |

## 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:

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| **Apply** | • Identify and investigate prospective risks throughout the first 5 phases of the exam<br>• Perform independent testing when appropriate but recognize that a review of prospective risks will often focus on the insurer's ability to manage them<br>• Recognize the significance of prospective risks facing the company and ensure that investigation and testing of these risks is prioritized<br>  ○ Depth of investigation for prospective risks should be similar to depth of investigation for traditional key activity risks.<br>• Share results of the prospective risk assessment with the department analyst |
| **Avoid** | • Identifying overly broad or obscure risks that don't clearly indicate the risk to the company<br>• Limiting assessment of prospective risks to phases 1-2<br>• Documenting the assessment of a prospective risk on Exhibit V and in a Key Activity, without clarifying how the risks interrelate<br>• Relying on management assertions or future plans to address a risk, without obtaining corroborating support<br>• Passing a prospective risk back to the analyst without gathering additional information to assist the analyst in ongoing monitoring |

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

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| **Apply** | • 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<br>  ○ Require notification if an essential contractor initially selected becomes unavailable to perform the examination<br>• Provide access to relevant state laws and regulations and state specific compliance procedures as necessary for reference on the examination. Ensure an open line of communication between the contractor and department designee for knowledge sharing to ensure contractors have access to participate in relevant meetings and discussions along with prior exam work papers as well as to discuss questions and any examination findings.<br>• Ensure department designee is actively involved in overseeing work completed by contractors, including review of significant workpapers in planning, fieldwork, and exam wrap-up (for more guidance see Section 1.III (G) in the Financial Condition Examiners Handbook)<br>  ○ Provide challenging and in-depth review of work performed by contractors, including setting an expectation that contractors address coaching notes or other feedback in a timely manner (i.e., two weeks) |

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| | • Develop specific guidelines to control the cost of the examination with the use of contractors to ensure an efficient and effective exam. Monitor the budget continuously and require approval for any adjustments to the budget once set.<br>• Subject contractors to an evaluation to gauge performance and keep a record of results for use in future hiring decisions<br>• 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. |
| **Avoid** | • Utilizing more contractors than can be adequately trained, monitored and supervised<br>• Using multiple contract examination firms on a coordinated group if possible<br>• Assigning too many concurrent projects to one department designee |

Supervisory Review Sound Practices:

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| **Apply** | • Challenge inherent risk assessment when areas that generally have high risks (e.g., reserving) do not have any "high" inherent risks identified<br>• 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<br>• 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<br>• Consider whether risks have been customized and if not, challenge whether standard repository risks and controls are appropriate or if additional customization is needed<br>• 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 |
| **Avoid** | • Delaying supervisory review of work such that coaching and feedback is no longer timely and may be challenging to address<br>• Signing off on multiple workpapers or whole sections of the exam file at one time, without adequately reviewing each item signed-off on (i.e., power ticking)<br>• Significantly revising or correcting work in the exam file without having the initial preparer or a secondary reviewer sign-off on the changes made |

Sound Practices in using Coaching Notes:

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| **Apply** | • Provide in-person coaching or "real-time" review for complex areas or issues<br>• Provide clear and concise action items within coaching notes<br>• Use coaching notes to highlight work that was done particularly well, as well as areas that could be improved |
| **Avoid** | • Documenting large paragraphs of coaching notes for complex areas<br>• Including too many action items in a single coaching note<br>• Making significant changes to the exam work product without providing feedback to original preparer<br>• Providing coaching notes for insignificant items (i.e., preferential wording changes, minor edits, etc.) |

Sound Practices in Utilizing CPA/Internal Audit workpapers:

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| **Apply** | • Notify the auditors of an upcoming exam as early as possible to obtain and review workpapers where appropriate<br>  ○ 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<br>  ○ Obtain current year workpapers prior to finalizing exam to ensure any issues identified are appropriately considered<br>• 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<br>  ○ 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<br>• Rationale supporting planned reliance on audit work to reduce review of financial reporting risks should be adequately supported<br>  ○ 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)<br>  ○ 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<br>• 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)<br>• 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<br>  ○ 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)<br>  ○ If errors or issues noted in conducting a detailed review of audit workpapers are pervasive, consider whether the initial conclusion on the audit function reached in Phase 1 should be re-assessed<br>• Retest / reperform one or a few of the samples to gain an understanding of the testing performed, when appropriate (for example, when significant reliance is placed on a high risk of the company)<br>• If difficulties accessing CPA workpapers are encountered, leverage guidance established by the NAIC/AICPA (E) Working Group |
| **Avoid** | • Bringing all CPA workpapers, including those not used, into the examination file<br>• Providing extensive documentation as to why certain financial reporting risks tested by the CPA won't be addressed during the exam, thereby limiting the efficiencies to be gained<br>• Relying on CPA testwork without ensuring that the testing directly addresses the risks of the examination |

## Other Resources:

The following resources provide additional considerations for risk-focused examinations that coordinated and/or subject to ORSA requirements.

Coordination Tools and Resources

| Resource | Description |
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| Coordination FAQ | Frequently asked questions and related answers to common coordination-related issues. This document is developed and maintained by the Financial Examiners Coordination (E) Working Group |
| FEETS | Financial Exam Electronic Tracking System (FEETS) is a regulator-only application use for planning, scheduling, and tracking financial examinations. It may also be used to share relevant information with other regulators (e.g., exam start date, completed exam report, completed management letter, etc.), as well as assist with planning for coordinated exams. |
| Analysis and Examination DOI Contacts | This document provides key analysis and examination contacts within each state insurance department. |

ORSA Tools and Resources

| Resource | Description |
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| ORSA Review Tools | This webpage includes a number of tools and resources related to the ORSA, including foundational knowledge, references to relevant NAIC Publications, best practice documents, and instructional webinars. |
| ORSA Sound Practices | This document (which can be found on the ORSA webpage linked above) outlines key sound practices identified through the 2019 ORSA-themed Peer Review Program. Sound practices outlined within this document apply to the analysis and examination functions. |

# 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 found to be effective for:

- Integrity, ethical values and behavior of key executives
- Management's control consciousness and operating style
- Management's commitment to competence
- Participation in governance and oversight by the audit committee and those charged with governance
- Organization structure and assignment of authority and responsibility
- Human resource policies and practices
- Formalized risk assessment process
- Monitoring of controls
- Communication process

ABC Audit also concluded the Company's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies for the insurance industry. Management's selection and application of accounting policies do not give rise to a risk of material misstatement in the financial information reported.

Identified Risk of Material Misstatement Due to Fraud:

- Improper recognition of earned premium related to the recognition of top-side financial statement close journal entries to circumvent the routine processes for revenue recognition and related controls for P&C business and manage earnings.
- Manipulation of the estimate of IBNR reserves for P&C business.

Audit Strategies

- 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 impairment is reasonable and the review for impairment did not identify any needed adjustment.
    - Management properly classified financial instruments measured at fair value.
    - No exceptions were noted in the testing of NAIC designations.
- Substantiate the income tax accounts.
    - No deficiencies were identified in the design or operation of the tax-related controls.
    - All significant deferred income tax items have been properly accounted for in the tax provision.
    - Income tax accounts are free of material misstatement.
- Evaluate data and related assumptions provided to CPA hired actuaries to value the liability for pension and postretirement benefits.
    - The work of CPA hired actuary constitutes relevant and reliable evidential matter to support the reasonableness of the pension and OPEB plan balances.
- Assess the process followed by management to value and record compensation expenses.
- Assess the process followed by management to review goodwill.

Conclusion

Given the general effectiveness of the audit work noted through a review of the areas described above, the exam team will reduce its review of financial reporting risks in those areas

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 |

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 testing was performed on the purchases and sales of securities. Based on the haphazard sample selection of 11 purchases and 1 sale, investments acquired and disposed of were properly recorded. ABC randomly sample 1 fixed income security per entity and recalculated accrued interest and amortization. No exceptions were noted related to investment account balances.

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

**Premiums and Receivables**
Revenue account risks were mapped and control testing was performed (1500). ABC noted revenue account controls meet all the control objectives and have been properly implemented, no exceptions were noted. ABC obtained a detailed data dump from the system by entity and tied premium totals to the GL. ABC utilized dollar unit sampling for pooled premiums, subsequently, ABC randomly selected a month to test for each selection and obtained the monthly premium detail to determine the monthly written premium. The initial MUS of 35 policies were tested for original application attributes, written premium amount and agreed premium to payment received. Note: In order to agree premium to payment received (step 3), ABC had client pull all invoices for the selected month of the companies noted below. ABC sighted amount from invoice was included in batch deposit listing and also sighted batch total hitting appropriate bank statements. Substantive analytical review was performed over premiums written and unbilled premium receivable. ABC noted the trends appeared to follow expectations and noted no exceptions. ABC haphazardly selected an additional 11 policies to test the accuracy of the earned and unearned premium calculation. No exceptions noted.

Work performed by ABC appears to be adequate to rely upon related to stated premium and receivables balances as of 12/31/2013 and may be relied upon to reduce financial reporting risks.

**Expenses**
ABC reviewed all expense account groupings/mappings on operating expense leadsheet (8203). ABC then created a flux analysis automatic document and formatted it to be a 'variance by group with group subtotals'. At the flux analysis document, ABC identified those accounts/mappings that were tested in other areas. Any expenses tested

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 traced it through the bank statement.

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

**Conclusion**
Based on the work described above, the exam team concludes that the independent audit work performed at 12/31/13 is sufficient to reduce the exam team's review of financial reporting risks in the areas of Cash & Investments, Premiums & Receivables, Expenses and Taxes.

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
- 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.