Date

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Le Président

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Dear Sir,

Re: Preliminary Exposure Drafts for Potential IAA Standards regarding International Financial Reporting Standards

FEE (Federation of European Accountants, Fédération des Experts Comptables Européens) is pleased to submit its observations on the first set of preliminary exposure drafts for potential IAA Standards regarding IFRS. FEE is the representative organisation for the accountancy profession in Europe with membership of 44 professional institutes of accountants from 32 countries in total representing more than 500.000 accountants in Europe.

FEE acknowledges the benefits of the IAA developing guidance with a view to establishing globally consistent actuarial practice for its members when they are providing professional services to undertakings preparing financial statements in accordance with International Financial Reporting Standards – IFRSs. It is appropriate to consider the context within which financial statements are prepared and the different responsibilities in relation to their presentation and preparation.

As a number of our comments raise significant issues of principle and are generally applicable to each Exposure Draft, we address those in this covering letter. Our detailed comments on certain provisions of individual Exposure Drafts are annexed hereto.

Status of Guidelines

We recommend that the IAA revisit its proposals to distinguish the material which is intended to constitute guidance on "best practice" from other application material presently contained within the Exposure Drafts. In our opinion, the latter category constitute informative and/or educational material which is appropriate for the IAA to prepare for the benefit of its members, but, should not be given the status of formal guidance, even of a non-mandatory nature (Class 4 status).

The footnote on the front page of each Exposure Draft states

> "Practice Guidelines are educational and non-binding in nature. They represent a statement of appropriate practices, although not necessarily defining uniquely practices that would be adopted by all actuaries."

The development and promulgation of these Practice Guidelines will assist in the development of a globally high quality standard and consistent approach by actuaries which FEE welcomes. Actuaries are more likely than not to follow that guidance. Competent and conscientious actuaries, if choosing to act in a manner other than suggested in the relevant Guideline, are likely to document that departure and outline their professional judgment as to the preferable nature of that alternative approach in the circumstances of the particular reporting entity.

Scope

It is probable that in several European countries, for example private limited companies carrying out the business of insurers will not be obliged, and may not opt in the short-term, to prepare financial statements in accordance with IFRSs. Such companies will continue to prepare their annual accounts in accordance with local Generally Accepted Accounting Principles (GAAP). Accordingly, it is proposed to add the following note in the Scope section:

> “This Practice Guideline has been developed in the context of insurers presenting their financial statements under International Financial Reporting Standards. The practices outlined herein may be equally applicable to the circumstances of insurers preparing their financial statements under local GAAP.”

FEE proposes that the eventual Practice Guidelines clarify that the guidance contained therein is (generally) as relevant to the third party independent actuary as to the actuary employed by the insurer itself.

Responsibility for the Financial Statements

The IAA guidance must necessarily have regard to the primary responsibility of those charged with governance, generally the Board of Directors or equivalent body having collective responsibility for carrying out the undertaking’s business and, amongst other matters, for the preparation and presentation of the undertaking's financial statements providing information about its financial position, trading performance during the reporting period and changes in financial position. As a wide range of users have to rely on the financial statements as their major source of financial information, such financial statements should be prepared and presented with their needs in view. We are of the opinion that, in the context of assets and liabilities subject to actuarial valuation, the actuary has an important role to play in assisting management to fulfil its responsibility.

Responsibility of the Statutory Auditors

It is the responsibility of the statutory auditors to perform the auditing procedures required by the applicable auditing standards and to issue an independent report on the financial statements including their audit report. Auditors have primary responsibility for their opinion on the financial statements. They may rely on the work of an expert, for example, an actuary, in order to obtain sufficient appropriate audit evidence regarding certain financial statement assertions.

The auditors’ education and experience enables them to be knowledgeable of business matters in general. In insurance matters, they could themselves perform actuarial work as part of the audit, or conduct specific actuarial approaches to corroborate the work of actuaries. They could also use the expertise of a person trained or qualified to engage in the actuarial practice. When the use of an expert is required, the International Standard on Auditing “Using the Work of an Expert” – ISA 620, requires the auditor to assess:

(i) The professional competence of the expert;

(ii) The objectivity of the expert; and
(iii) The appropriateness of the expert's work as audit evidence regarding the financial statement assertions being considered.

The procedures performed by auditors follow auditing standards. In an increasing number of European countries, national standards are based on ISAs (International Standards on Auditing). Within the EU the proposed Eighth Directive requires statutory auditors and audit firms to carry out statutory audits in accordance with international auditing standards adopted by the Commission. Actuarial work by auditors is necessarily conducted within this context. IAA guidance regarding IFRS is an opportunity to standardise actuarial work and to facilitate appropriate audit evidence.

Interpretation of IFRSs

The International Financial Reporting Interpretations Committee – IFRIC – was established in March 2002 by the International Accounting Standards Committee Foundation. Its role is to provide timely guidance on newly identified financial reporting issues not specifically addressed in the IFRSs, or issues where unsatisfactory or conflicting interpretations have developed, or seem likely to develop. In this manner it promotes the rigorous and uniform application of the IFRSs. IFRIC is the sole global authority in providing supplementary interpretations, where deemed necessary, regarding detailed aspects of the IFRSs. Accordingly, we suggest the IAA to have due regard for the role of IFRIC when preparing its proposed International Actuarial Standards of Practice (IASP) to avoid being involved in setting interpretations of IFRSs.

We would be pleased to discuss any aspect of this letter with you. We thank the IAA for the opportunity to comment on its proposals and would welcome the opportunity to comment on any future developments.

Yours sincerely,

David Devlin
President

APPENDIX

General questions

1. *Do the drafts provide adequate and appropriate guidance for the application of IFRS 4 and related IFRSs?*

FEE supports the IAA initiative of establishing a set of International Actuarial Standards of Practice (IASP) regarding financial reporting under IFRS, providing educational material on a high-level basis to the members of their associations, to ensure a common understanding of IFRS and to enhance the quality of actuarial work.

2. *In which areas would you recommend additional guidance? To what extent is the guidance inappropriate or unnecessary?*

We refer to the comments to specific standards.

3. *If you are an IAA member association, what are your plans regarding implementation of this Practice Guideline? Where IFRS is the required reporting basis in your jurisdiction, do you intend to introduce similar standards or use this guidance? What are your plans for members practicing in other jurisdictions?*

Not applicable

4. *Other comments.*

We have no other comments.

Actuarial Practice

5. *The Practice Guideline proposes in section "4.1.6 Material inconsistencies" that the actuary should consider whether management's selection of the measurement basis could result in materially misleading results. Do you consider this section appropriate? If not, why not and do you have any suggested alternative?*

This section is appropriate as far as the actuary forms part of the overall process of the preparation of the financial instruments.

We are concerned that Section 4.1.6 as currently drafted may imply that the actuary should take direct responsibility for the review of measurement and presentation of all assets and all liabilities in the financial statements. The text needs amendment to clarify that this is not the responsibility of the actuary but the primary responsibility of those charged with governance of the reporting entity. However, should the actuary become aware of inconsistencies between the valuation of assets and liabilities calculated on an actuarial basis and other assets and liabilities he should draw them to the attention of the directors, management and auditors as appropriate.

6. *The Practice Guideline takes the position in section "4.2.8 Model and assumptions" that, to the extent the actuary selects or takes responsibility for assumptions, the actuary should consider their reasonableness on an aggregate basis. Do you consider this section to be appropriate? If not, on what basis should the reasonableness of the assumptions be considered?*

In relation to the assumptions chosen by the actuary, alternatives and effects of the specific choice have to be described, sensitivity in relation to other choices have to be disclosed, so that they are understandable for the preparers of financial reports.

It is the responsibilities of those charged with governance of the reporting entity to satisfy themselves, drawing on input from the actuary, as to the reasonableness of the assumptions underlying the model used in determining the valuation the amounts of the assets and liabilities on an actuarial basis. However, the actuary would himself assess the reasonableness of those assumptions on an aggregate basis.

7. *Other comments.*

The guidance in "4.1.4 Financial reporting requirements" gives a selection of accounting principles which should be relevant to the professional services provided by the actuary. Instead of selecting some accounting principles, the IASPs should refer to the relevant accounting standard, here IFRS 4 Insurance Contracts, and to the application of accounting principles in general. As the actuary's work is an integral part of the preparation of financial reports, the financial reporting requirements for the actuary's work need not deviate from those for the preparation of financial reports.

Sections 4.2.4 and 4.2.5 cover what is described as "deviation from standard of practice", either because statutes so requires or for other reasons. It is suggested that disclosure should be made as to why the actuary was obliged or chose to deviate from the Practice Guideline as well as of the impact of that change. The suggested contents for the actuary's report contained in Section 4.3.2 includes:

> "Indicate whether the work has been performed in accordance with recognised practice and applicable Practice Guidelines, and, if not, disclose material deviations from them".

FEE acknowledges it is desirable for an actuarial report to state whether or not the relevant IASP have been followed. An actuary should not state that these Guidelines have been followed where this is not the case. However, requiring a description or justification of any departure appears to assign "Standard status" to those pronouncements. We consider that these paragraphs appear to set a "comply or explain" regime. The principle underlying such approach is acceptable, but would appear to be inconsistent with the stated non-binding nature of this guidance.

4.2.10 "Materiality" proposes that the actuary should consider what may be material for actuarial purposes. The consideration of materiality is one of the key considerations in preparing financial reports and is determined following the judgement of the preparer of the financial report. Any consideration of what may be material for actuarial purposes has to be in compliance with the decision for materiality for accounting purposes. In this respect, the Basis for Conclusion to the Exposure Draft seems to be stronger than the Guidance itself.

Even though chapter 4.3 "Report of the actuary's work" does not directly influence the auditor's or accountant's work, the actuary's report needs to have regard to the requirements for auditors and accountants.

The usefulness of the list of selected IFRSs in Appendix B is questionable. Any financial report claiming to be in compliance with IFRS needs to comply with all IFRSs, not only with a selection of them. In IAS

1 ‘Presentation of Financial Statements’, it states that financial statements shall not be described as complying with IFRSs unless they comply with all the requirements of IFRSs.

Measurement of Investment Contracts and Service Contracts under IFRS

8. *The Practice Guideline takes the position, when calculating the carrying value for a financial instrument on an amortised cost or fair value measurement basis and with accruals for service contracts that the calculations should first be performed applying the methodology and subsequently applying the additional accounting requirements. Do you consider this section to be appropriate? If not, what process would be appropriate?*

It should be considered whether it might be more useful that accounting requirements on fair value measurement are part of the development of a fair value model.

As many of the issues arising from fair value modelling derive from the accounting policy of the entity, we suggest it is appropriate for the actuary to refer to compliance with the entity’s accounting policy.

9. *The Practice Guideline takes the position in section “4.4.7.2 Level of margins for risk and uncertainty” proposes that the actuary should select the level of confidence in selection margins for risk and uncertainty. Do you consider this approach to be appropriate? If not, what would you consider appropriate?*

It is the responsibility of management to determine the level of confidence. It is appropriate to disclose the approach adopted.

10. *The Practice Guideline takes the position in section “4.4.8.2 Calibration” that the approach to calibration should be left to the actuary’s judgment. The actuary should consider the limited market for investment contracts where the insurance company is the issuer and consider what observable data is available. Do you consider this approach to be appropriate? If not, what process would you consider appropriate and should a different priority be placed on calibration to the total price or, where additional observable data is available to the individual elements?*

The measurement of financial liabilities is a matter for the responsible management of the reporting entity and is determined in the context of the financial statements as a whole. The measurement of financial liabilities, issued by an insurer similar to insurance contracts, needs to be consistent with the measurement approach in the accounting policies of an entity for financial liabilities in general.

11. *Other comments.*

IAS 39 provides guidance on determining the fair value, as well as for embedded derivatives (fair value hierarchy). 4.1.4 “Host investment contract with embedded derivative” refers to “commonly accepted option-pricing models” but not to the guidance given within IAS 39. This is not in compliance with IAS 39.

The approach described in 4.2.4 “Renewals” regarding the consideration of renewal premiums needs to be implemented in the accounting policies of the entity, instead of being at the discretion of the individual actuary. Although the approach seems to be a logical and consistent application of the consideration of lapse rates (renewal premiums understood as negative surrenders), this approach is far beyond practice guidance to IFRS and therefore needs to be discussed for each individual case with the management.

4.4.1 “Background” refers to a “maximum practical use of market input” when using a valuation technique. On the contrary, IAS 39 Application Guidance paragraph 75 requires the use of market data as extensively as possible. The IASP wording should be consistent with the requirements in IAS 39.

In 4.4.7.2 “Level of margins for risk and uncertainty” it is assumed that the margin for risk and uncertainty shall “be sufficient to cover all obligations a certain percentage of occasions”. This indicates the objective of prudence accounting, i.e. to ensure that the debtor is able to cover its obligation at certain security level. The margin for risk and uncertainty charged by a party for accepting the obligation is not only the possible deviation up to a certain probability but the economic price of the entire deviation.

Current estimates

12. The Practice Guideline takes the position in section “4.1.1 Approach” that the practitioner should consider whether the assumptions are reasonable in aggregate. Do you consider this section to be appropriate? If not, on what basis should the reasonableness of the assumptions be considered?

We have no other comments.

13. The Practice Guideline takes the position in section “4.2.2 Market assumptions” that “the practitioner usually selects market assumptions that are consistent with current market prices and other market data, unless there is reliable and well-documented evidence that current market experience and trends are not likely to continue.” In taking that position it is recognised that there may be observable market data that the practitioner, based on his/her judgment considering other objective evidence, has chosen not to follow. Do you consider this approach to be appropriate? If not, what would you consider appropriate?

We query the practicality of the assessment “…that current market experience and trends are not likely to continue.” One would expect an objectively identifiable event to be anticipated by the capital markets and, therefore, be reflected within current market prices. The reporting entity should be able to demonstrate the existence of a subjectively identifiable event which has not been taken account by other market participants. Accordingly, we would expect this exception to only arise in rare circumstances, if at all.

14. Other comments.

4.1.5 “Correlation between assumptions” refers to specific approaches for choosing assumptions for contracts with discretionary participation features. IFRS 4 allows an entity to continue its existing accounting policies for contracts with a discretionary participation feature. Therefore, it permits the continuation of currently used approaches to determine assumptions. If a contract with a discretionary participation feature is split into its components, the component without discretionary participation feature is subject to IAS 39 or IAS 18. The commentary in 4.1.5 needs to be consistent with the provisions of IFRS 4.