

CFE 1

Effective January 1, 2009

Examination Methods and Management

(Passing grade for this exam is 66)

This study guide is intended to be a tool for identifying key areas of emphasis in studying for the CFE 1 test. This test covers materials and concepts in the 2008 Edition of the Financial Condition Examiners Handbook (FCEH) published by the NAIC.

The study guide should be used as a starting point for key concepts and materials on which you will be tested. Note that the items referenced in this guide may exist in more than one section of the FCEH. Examiners should be aware they are responsible for information from all sections of the FCEH.

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CFE #1 focuses primarily on the materials in the FCEH pertaining to risk focused examinations. The FCEH serves as the sole source of examination material for this examination.

The FCEH and this study guide are required reading for the CFE #1 course. All of the questions on the test have been developed from information included in the FCEH or the study guide. The study guide has been developed to assist the examiner in focusing on the concepts and sections contained in the FCEH.

PREAMBLE

- Mandatory accreditation standard after January 1, 2010
- Allocation of examination resources to high risk areas
- Supervisory plan
- Differentiation from Specific Risk Analysis Approach
- Corporate Governance

SECTION 1 — RISK-FOCUSED EXAMINATIONS

INTRODUCTION

HISTORY OF RISK ASSESSMENT AND PROCESS OF CONDUCTING EXAMS

- Formal process
- Risk focused methodology

OVERVIEW OF RISK-FOCUSED SURVEILLANCE PROCESS

- Identification of risk in an insurer's operation
- Identification of significant risks
- Effect procedures to monitor solvency of insurers

RISK-FOCUSED SURVEILLANCE CYCLE

- Coordinated efforts between examination and analysis

- Supervisory Plan
- Risk-Focused Surveillance Cycle
 - Supervisory Plan
 - Examination
 - Financial Analysis
 - Priority System
 - Internal/External Changes

GOALS OF RISK-FOCUSED EXAMINATIONS

- Allocation of resources to high risk areas
- Risk Matrix

RISK-FOCUSED EXAMINATION PROCESS

- Seven Phases

APPLICATION OF THE RISK-FOCUSED SURVEILLANCE PROCESS

- Great deal of variation depending on complexity of insurer

CONFIDENTIALITY

- NAIC Model Law on examinations

RELATIONSHIP TO THE MARKET CONDUCT SURVEILLANCE SYSTEM

- Compliance with laws versus solvency

PHASE 1 – UNDERSTAND THE COMPANY AND IDENTIFY KEY FUNCTIONAL ACTIVITIES TO BE REVIEWED

PART 1: UNDERSTANDING THE COMPANY

- STEP 1: GATHER NECESSARY PLANNING INFORMATION
 - Risk management environment
 - SAS 70 Reports
- STEP 2: REVIEW OF GATHERED INFORMATION
 - Analytical review procedures
- STEP 3: ANALYTICAL AND OPERATIONAL REVIEWS
- STEP 4: CONSIDERATION OF INFORMATION TECHNOLOGY RISKS
- STEP 5: UPDATE THE INSURER PROFILE SUMMARY

PART 2: UNDERSTANDING THE CORPORATE GOVERNANCE STRUCTURE

- Tone at the top
- Management interviews

PART 3: ASSESSING THE ADEQUACY OF THE AUDIT FUNCTION

- Internal/external audit
- CPA workpapers

PART4: IDENTIFYING KEY FUNCTIONAL ACTIVITIES

- Financial reporting
- Other than financial reporting

PART 5: CONSIDERATION OF PROSPECTIVE RISKS FOR INDICATIONS OF FUTURE SOLVENCY CONCERNS

- Impact on financial statements

PHASE 2 – IDENTIFY AND ASSESS INHERENT RISK IN ACTIVITIES

IDENTIFYING THE RISK

- Risks other than financial reporting
- Financial reporting risks

IDENTIFYING THE TYPE OF RISK

- Credit
- Market
- Pricing/underwriting
- Reserving
- Liquidity
- Operational
- Legal
- Strategic
- Reputational

ASSESSING THE INHERENT RISK

- Likelihood of occurrence

- Magnitude of impact

- Overall inherent risk
 - High inherent risk

 - Moderate inherent risk

 - Low inherent risk

PHASE 3 – IDENTIFY AND EVALUATE RISK MITIGATION STRATEGIES (CONTROLS)

- IDENTIFYING/EVALUATING RISK MITIGATION STRATEGIES/CONTROLS
 - Assessment of internal control environment

 - Risk mitigation strategies

 - Five principals of mitigation

 - Insurer's design of controls

- CONSIDERATION OF SMALL/MEDIUM SIZED INSURERS
 - Existence of controls

- TESTING AND RELYING ON RISK MITIGATION STRATEGIES/CONTROLS
 - Testing and relying on mitigation strategies

 - Reliance on prior year control testing

 - Risk Mitigation Strategies/Processes
 - Strong

 - Moderate

 - Weak

- INTERNAL CONTROL TESTING

- Preliminary Assessment
- Financial reporting risks
- Testing CPA workpapers
- Reliance on control testing performed in prior years

EXAMINER USE OF SARBANES-OXLEY DOCUMENTATION

- PCAOB
- Adoption of standards for auditors
- INFORMATION TO BE OBTAINED BY THE EXAMINER
- UTILIZING SARBANES-OXLEY REPORTS FOR EXAMINATIONS
- REQUEST OF INFORMATION AND ADDITIONAL GUIDANCE

PHASE 4– DETERMINE RESIDUAL RISK

- Control Deficiency
- Significant deficiency
- Material weakness
- Residual Risk Assessment Ratings
 - High residual risk
 - Moderate residual risk
 - Low residual Risk

PHASE 5– ESTABLISH /CONDUCT EXAMINATION PROCEDURES

ESTABLISH/CONDUCT EXAMINATION PROCEDURES

- Risk Assessment Matrix

RISKS OTHER THAN FINANCIAL REPORTING

FINANCIAL REPORTING RISKS

- Residual Risk Assessments
- Examination Assertions

EXAMINATION DELIVERABLES

- Findings and Conclusions
 - Current
 - Prospective
- Reports

PHASE 6– UPDATE PRIORITIZATION AND SUPERVISORY PLAN

PRIORITIZATION

SUPERVISORY PLAN

PHASE 7 – DRAFT EXAMINATION REPORT AND MANAGEMENT LETTER

EXAMINATION REPORT

MANAGEMENT LETTER

SECTION 2 — EXAMINATION EXHIBITS

EXHIBIT A: EXAMINATION PLANNING PROCEDURES CHECKLIST

EXHIBIT B: EXAMINATION PLANNING QUESTIONNAIRE

EXHIBIT C: EVALUATION OF CONTROLS IN INFORMATION SYSTEMS (IS) QUESTIONNAIRE

EXHIBIT D: TOOLS FOR AUTOMATED EXAMINATIONS

EXHIBIT E: CPA REVIEW CHECKLIST

EXHIBIT F: ANALYTICAL REVIEW PROCEDURES

EXHIBIT G: CONSIDERATION OF FRAUD

EXHIBIT H: INSURER PROFILE SUMMARY

EXHIBIT I: EXAMINATION PLANNING MEMORANDUM

EXHIBIT J: RISKASSESSMENT WORKSHEET

EXHIBIT K: RISK ASSESSMENT MATRIX

EXHIBIT L: ASSESSMENT OF CONTROLS

EXHIBIT M: UNDERSTANDING THE CORPORATE GOVERNANCE STRUCTURE

EXHIBIT N: BRANDED RISK CLASSIFICATIONS AND COMMON ACTIVITIES AND SUB-ACTIVITIES

EXHIBIT O: EXAMPLES OF RISKS

EXHIBIT P: REVIEW OF EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

EXHIBIT Q: REVIEW AND APPROVAL SUMMARY (RAS) FOR EXAMINATIONS

EXHIBIT U: SUPERVISORY PLAN

EXHIBIT V: PROSPECTIVE RISK ASSESSMENT

EXHIBIT Y: EXAMINATION INTERVIEWS

EXHIBIT Z: EXAMINATION COORDINATION