

WHITE PAPER

MODEL AUDIT RULE A HOLISTIC APPROACH TO INTERNAL CONTROL

By Susan Hanlon, CPA and Lewis Bivona, CPA, AFE

1.22.09



WithumSmith+Brown, PC

Certified Public Accountants and Consultants

New Jersey. New York. Pennsylvania. Maryland. Florida. Colorado

A member of HLB International. A world-wide network of professional independent accounting firms and business advisers.

MODEL AUDIT RULE A HOLISTIC APPROACH TO INTERNAL CONTROL

By Susan Hanlon, CPA and Lewis Bivona, CPA, AFE

WHITE PAPER

The information contained in this document represents the current view of **WithumSmith+Brown, P.C.** on the issues discussed as of the date of publication.

This white paper will inform the reader of key changes required by the Model Audit Rule for insurance companies. It also emphasizes companies can, by leveraging internal control activities and integration of good governance practices, achieve higher value for shareholders and management of risk.

The paper will cover the following key points:

- Key requirements of the Model Audit Rule
- Define key risk areas where insurance companies should focus their energies.
- Correlation between evaluating control risk and maintaining shareholder values
- The Model Audit Rule's potential to lower both audit costs and examination fees.
- Don't be afraid to ask for help early!

This white paper is for informational purposes only. It is advised that you discuss your business's individual needs with a Certified Public Accountant to assess how your business must respond to changing market conditions within your industry.



WithumSmith+Brown, PC

Certified Public Accountants and Consultants
New Jersey, New York, Pennsylvania, Maryland, Florida, Colorado

The underlying premise of enterprise risk management is that every entity exists to provide value for its stakeholders. A study conducted by Aon Re Global, found shareholder value can be created through consistently and successfully managing to a prudent level of enterprise risk. The study quantified a more than 30 percent valuation differential that exists for companies producing consistent quarterly earnings over those companies with more volatile earnings.

Integral to effective enterprise risk is internal control over financial and statutory reporting, and compliance with laws and regulations. It is more important than ever in today's volatile financial markets to avoiding damage to your company's reputation and preventing undesirable consequences.

Regulators and the National Association of Insurance Commissioners (NAIC) continue to uphold additional financial solvency standards due in part to the potential for Federal regulation of insurers as well as a greater need to regain investor confidence in financial reporting.

In 2001, the first integrated framework for internal control was issued by the Committee of Sponsoring Organizations (COSO). The Sarbanes Oxley Act of 2002 (SOX) was an outgrowth of COSO, SAS 70 audits became an integral part of

SOX compliance and now NAIC has adopted the Model Audit Rule (MAR), effective for the 2010 reporting year. MAR enhances provisions for:

- *Management Reporting of Internal Control over Financial Reporting ("ICFR")*
- *Auditor independence and scope services*
- *Enhancement of the requirement for independence of audit committee members.*

The Model Audit Rule is different from ("SOX") as it requires a management assertion not an external auditor's attestation; unlike SOX, MAR includes assertions about the effectiveness of internal controls for statutory financial reporting. The report includes the following:

- *Management has established internal control over financial reporting and an assertion, that is effective to provide reasonable assurance regarding the reliability of financial statement in accordance with statutory accounting principles*
- *A statement that describes the approach or processes by which management evaluated internal controls*
- *The scope of work included, what internal controls were excluded.*
- *Disclosure of un-remediated material*

(Continued on page 2)

- weaknesses in the internal control.*
- *A statement regarding the inherent limitation of internal control systems*
- *Signatures of CEO and CFO*
- *Independences standards for auditor have been changed.*
- *The report is due sixty (60) days from the filing of the audited financial statements, 1st report due in 2011.*

Entities that are Sarbanes-Oxley compliant will file their 404 report and an addendum stating that the internal controls having material impact on statutory financial were included in the scope of the Section 404 report. For internal controls with a material impact on statutory financial statement which are outside the scope of the Section 404 report, the insurer must file a section 16 report that covers those internal controls.

The year 2010 may seem a long way off, but planning for implementation of MAR should be done thoughtfully and without time constraints. There are many risk areas that are important for insurer to understand in terms of the audited statutory financial statements. Risk areas include:

- *Investments*
- *Policy and claim reserve*
- *Benefit payments*
- *Premiums*
- *Reinsurance*

- *Related party transactions*
- *Operating expenses*
- *Income taxes*
- *Contingent liability reserves*

Many of the reporting requirements have controls in common. Section 404 of SOX requires independent auditors to assess and express an opinion on the effectiveness of internal controls over financial reporting, including service organization controls. Service organizations that constitute a key element of the financial reporting can satisfy this requirement by providing an SAS 70 audit. Preparing for MAR is an opportunity to evaluate controls that customers require, and the SAS 70 report can be a by-product of the action plans. MAR can piggy back off of SOX to include assurances of statutory controls.

A by product of preparing for the MAR is the potential to save on both your audit and regulatory examination fees. Companies that have taken the time to address and mitigate risks that have a bearing of financial reporting can utilize their documentation to assist both external auditors and state examiners to quickly assess risk. This preparation has a direct correlation to reducing redundant work by both of these parties, which saves the

(Continued on page 3)

MODEL AUDIT RULE A HOLISTIC APPROACH TO INTERNAL CONTROL

WHITE PAPER

company money. An added benefit of addressing the MAR is that it clearly demonstrates that management is serious about financial reporting.

Let us help you develop a Holistic internal control implementation plan that satisfies MAR requirements. Companies that have complied with SOX wished they had started earlier, which is why we recommend getting started now. This should give enough time to test, document, and remediate any deficiencies before the 2010 deadline.

More details of the rule may be found in the NAIC has adopted an Implementation Guide for the Model Audit Rule that is incorporated in the March 2007 Accounting Practices and Procedures Manual. This 40 page guide provides guidance for implementing the significant changes and can be found on the NAIC website at www.naic.org.



WithumSmith+Brown, PC

Certified Public Accountants and Consultants
New Jersey, New York, Pennsylvania, Maryland, Florida, Colorado