

ICAI's Seminar on Audit of Insurance Companies and Opportunities for CAs

Presentation on Critical Aspects of Internal Financial Controls (IFC) in Insurance Companies

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April 15, 2023

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Questions

Some Abbreviation - we need to know

Sr. No.	Abbreviation	Nomenclature/ Meaning
1	IFC	Internal Financial Controls
2	ICoFR	Internal Controls over Financial Reporting
3	TOD	Test of Design of Control
4	TOC	Test of Control (Operational Effectiveness)
5	IPE	Information Provided by Entity (being consulted/ audited)
6	ELC	Entity Level Controls
7	ITGC	Information technology General Controls
8	RCM	Risk and Control Matrix
9	CCM	Continuous Controls Monitoring
10	CSA	Controls Self Assessment

References

Sr. No.	Particulars
1	Companies Act, 2013
2	ICAI Guidelines
3	Experience in Insurance Sector

1. OVERVIEW OF IFC

BRIEF OVERVIEW OF INTERNAL FINANCIAL CONTROLS

IFC defined by Companies Act 2013

Section 134(5)(e) defines IFC as,

- **Policies and procedures** for ensuring **orderly and efficient conduct of business**; including
- **Adherence** to policies and procedures.
- Safeguarding of **Assets**;
- Prevention and detection of **frauds and errors**;
- **Accuracy and completeness** of the accounting records;
- **Timely** Preparation of **reliable** information.

What needs to done

Create **demonstrable documented framework** for Internal Financial Controls

Documentation of control that **mitigate the risk** of significant misstatements

Requisite **accountability** for financial reporting structure

Fraud risks mitigations and controls at the process level

Testing of Design & operating effectiveness of controls

Responsibility

Board's Report on adequacy & operating effectiveness of IFC [Sec 134 (5) (e) & Schedule IV; Clause 49 (1) (D)]

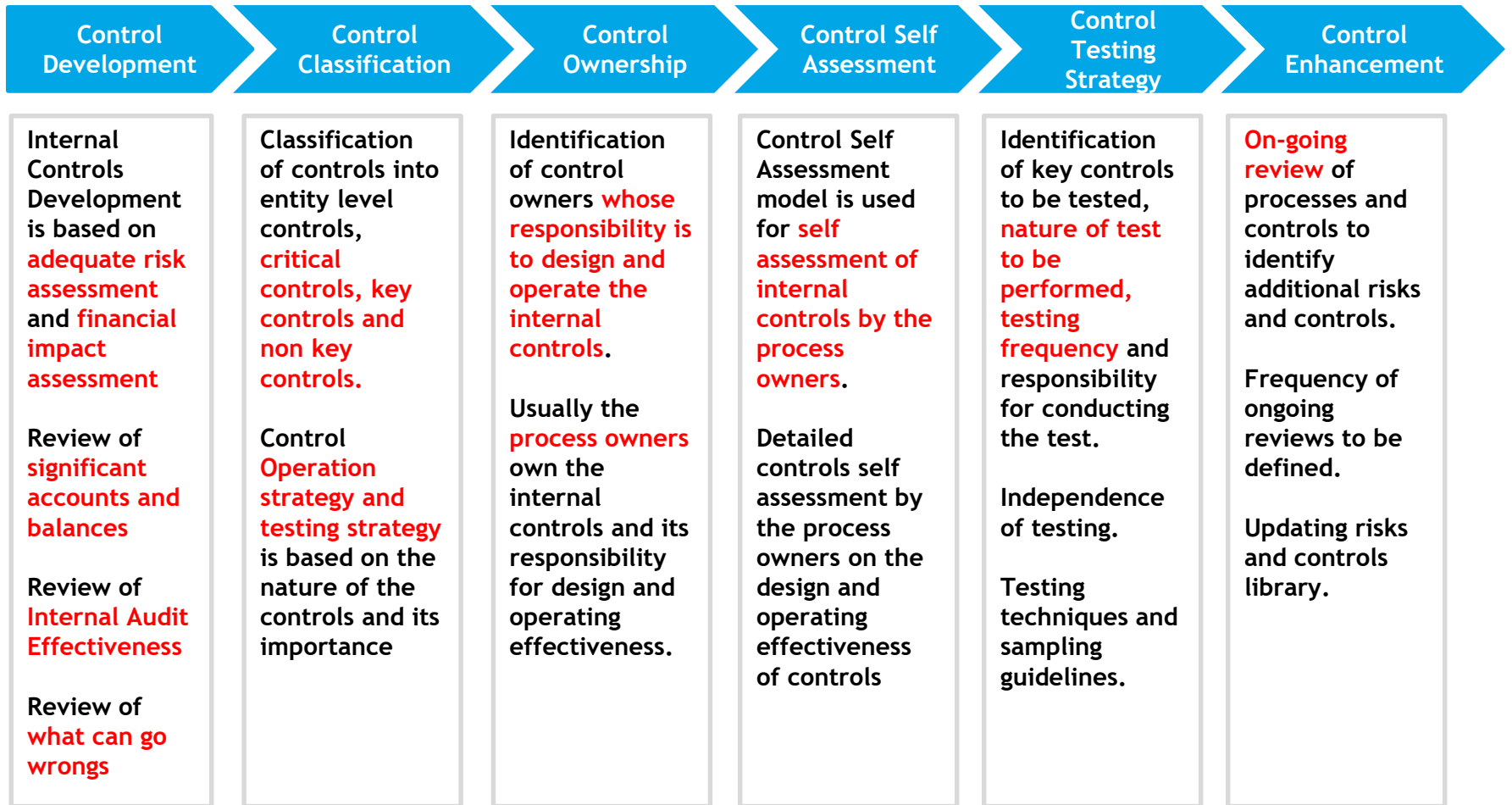
Audit Committee to evaluate IFC [Sec 177; Clause 49(III)(D)]

Board Report on adequacy of ICFR [The Companies (Accounts) Rules 2014 rule 8(5)(viii)]

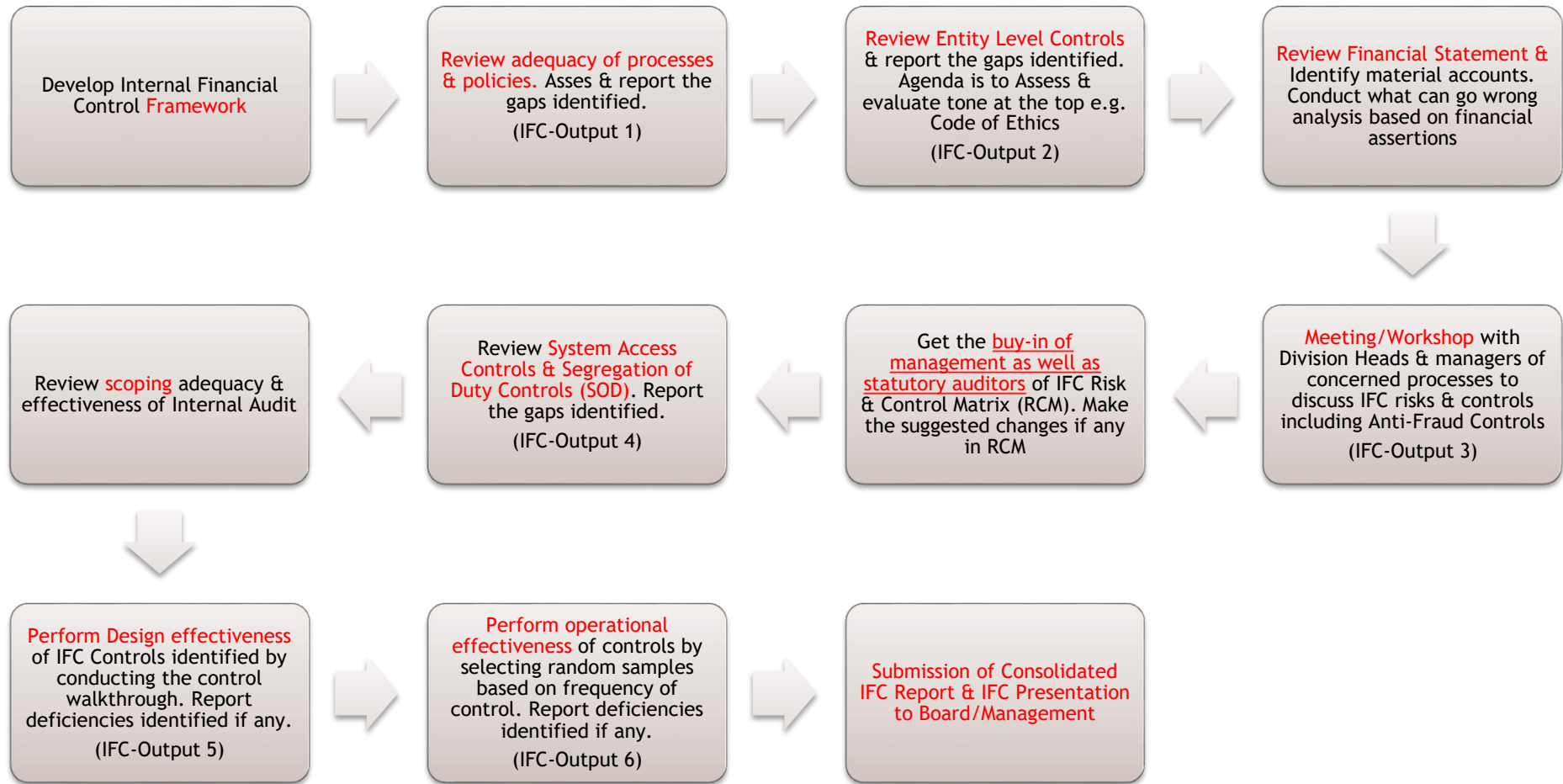
Auditors to evaluate & report on adequacy and operating effectiveness of IFC [Sec 143 (3)]

2. APPROACH AND METHODOLOGY

APPROACH AND METHODOLOGY



IFC - PROGRAM FLOW



3. PHASES AND CRITICAL COMPONENTS OF IFC RCMs

PHASE I - DESIGN OF CONTROLS (with illustrations)

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Area	Sub Area	Risk No.	Risk Description	Assertions
Premium Collection Accounting and Reconciliation	<ul style="list-style-type: none"> Premium Computation Premium Banking Premium Recognition and Accounting, etc. 	PR - R1 PR - R2, etc.	<ul style="list-style-type: none"> Risk of Incorrect computation of premium quotation. Risk of Delays/ Incorrect upload of premium matrix in premium computation system. Risk of Premium accepted from policy holder and not deposited in bank account/ Short deposit in bank. 	<ul style="list-style-type: none"> Existence or Occurrence Rights & Obligations Disclosure & presentation Completeness & Accuracy Valuation & Allocation

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Nature of Risk	Risk Rating	Control No.	Control Description	Process /Department
<ul style="list-style-type: none"> Operational Financial Regulatory Strategic Reputational, etc. 	Critical High Medium Low	PR - C1 PR - C2, etc.	<ul style="list-style-type: none"> Premium computation is auto generate from Premium calculator in System with maker checker controls. Premium matrix uploaded in premium computation system being supported by User Acceptance Test (UAT) sign off during product launch. Reconciliation of premium credited in Bank with Pay-in slip copy provided to Collection agent (CMS Agency) with maker checker controls. 	New Business Branches Accounts Team, etc. (Each area may have different departments involved)

PHASE I - DESIGN OF CONTROLS (with illustrations)

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Type of Control	Automated / Manual	Systems Used	Operating Frequency	Unit office
<p>Preventive e.g. Maker Checker Signoffs / Four Eye Principle</p> <p>Detective e.g. Periodic Reconciliation</p> <p>Key / Non Key Controls</p>	<p>Classification whether the control is performed through system or is manual.</p>	<ul style="list-style-type: none"> ▪ Policy Admin System, ▪ Actuarial System, ▪ Investment System, ▪ Document Management System, etc. 	<ul style="list-style-type: none"> ▪ Annual: e.g. Yearly Closures ▪ Quarterly: e.g. Quarterly Accounts Closures ▪ Monthly: e.g. monthly reconciliations ▪ Weekly: e.g. reconciliation ▪ Daily: e.g. EOD premium collection closures, daily banking, ▪ Many times a day: Multiple new business log ins. ▪ As needed: Changes to premium matrix in system 	<ul style="list-style-type: none"> ▪ Central Office/ Head Office ▪ Zonal Office ▪ Divisional Office ▪ Branch office ▪ Third Party (TPA's, Document Management, etc.)

PHASE II - TEST OF CONTROLS (with illustrations)

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Sampling Technique	Sample reviewed	Testing Period	Control Design Conclusion	Control Implementation Conclusion
<ul style="list-style-type: none"> Random Sampling Haphazard Sampling, Statistical, etc. 	Nos. of samples reviewed to be mentioned (Sampling as per ICAI's Guidance Note)	<ul style="list-style-type: none"> Test in Current Period, Using Prior Period Evidence. 	<ul style="list-style-type: none"> Effective Ineffective 	<ul style="list-style-type: none"> Implemented Not Implemented Partially Implemented

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Control Operating Effectiveness Conclusion	Design/ Operational Deficiency	Conclusion	Activity Performed for Control review	Control Year Last Tested
<ul style="list-style-type: none"> Effective Ineffective Partially Effective (8/10) 	<ul style="list-style-type: none"> SOP/ Manual not documented. Absence of Maker Checker Controls 	Mention whether the controls has: Passed Failed	<ul style="list-style-type: none"> Examination of Documentation Observation Inquiry 	Current FY Previous FY (for annual controls)

PHASE II - TEST OF CONTROLS (with illustrations)

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List IPE used in testing	Significant Findings or Issues	Risk of Material Misstatement / Fraud Risk	Findings and Observations	Classification of Inherent / Residual Risk
<ul style="list-style-type: none"> ▪ Bank Reconciliations, ▪ Approved Policies/ SOPs, Manuals, ▪ Minutes of Meetings, ▪ Registers, etc. 	<p>To be reported, if any, basis the TOC performed</p>	<p>To be reported, if any, basis the TOC performed</p>	<ul style="list-style-type: none"> ▪ None Noted, ▪ Deficiency, ▪ Identified Suspected Fraud, or ▪ Material Weakness, Significant Deficiency, ▪ Recommendation 	<ul style="list-style-type: none"> ▪ Normal ▪ Significant

4. AREAS TO BE COVERED - FOR COMPREHENSIVE IFC IN INSURANCE INDUSTRY

IFC RCM STRCUTURE

IFC consists of below Risk Control Matrices

Sr. No.	Areas
I	Entity Level Controls
II	Process Level Controls
a.	Actuarial Process
b.	Product Development & File and Use
c.	Commissions Calculation, Accounting & Payment, etc.
III	Information Technology General Controls (ITGC)

AREAS TO BE COVERED IN IFC (Insurance Industry)

To ensure the IFC RCMs are comprehensive the below mentioned areas/ sub areas to be covered:

Sr. No.	Areas	Critical Aspects
Core Business Function		
1	Actuarial Process	<ul style="list-style-type: none"> ▪ Solvency Margin ▪ Claim under litigation ▪ Reserves Signoffs ▪ Assumptions ▪ Preparation of Bordeaux ▪ ALM Computation ▪ IRDAI Reporting
2	Product Development & File and Use	<ul style="list-style-type: none"> ▪ Product Ideation and Design ▪ Product Management and Launch ▪ Product Specifications ▪ Product Change Management
3	Product Pricing	<ul style="list-style-type: none"> ▪ Product Pricing Model ▪ Scenarios/ Sensitivity Testing
4	New Business Processing	<ul style="list-style-type: none"> ▪ Proposal Logins ▪ Policy Holder details ▪ Dedupe Function ▪ Policy Dispatch ▪ Stamp Duty ▪ Back Dating

Sr. No.	Areas	Critical Aspects
Core Business Function		
5	Premium Collection Accounting and Reconciliation	<ul style="list-style-type: none"> ▪ Premium Computation ▪ Premium Banking ▪ Premium reconciliation with Bank Statements ▪ Premium Receipt/ Acknowledgement ▪ Short Collection ▪ Premium Cash Misappropriation ▪ Premium Safe Keeping ▪ Third Party Payments ▪ Counterfeit Currency ▪ Premium Recognition ▪ Advance Premium
6	Underwriting Process	<ul style="list-style-type: none"> ▪ Delegation of Authority ▪ Medical/ Financial U/w ▪ FATF List ▪ Policy Reinstatement ▪ Enhanced Due Diligence
7	Refund Processing	<ul style="list-style-type: none"> ▪ Refund Amount Computation ▪ Refunds Processing ▪ Refunds Accounting ▪ Unclaimed Refunds

AREAS TO BE COVERED IN IFC (Insurance Industry)

Sr. No.	Areas	Critical Aspects
Core Business Function		
8	Anti Money Laundering	<ul style="list-style-type: none"> ▪ AML Program. ▪ Suspicious Transaction Reports (STR) / ▪ Cash Transactions Reports (CTR) ▪ FIU-IND (Financial Intelligence Unit - India) Reporting.
9	Commissions Calculation, Accounting & Payment	<ul style="list-style-type: none"> ▪ Commission rates masters creation and modification ▪ Commission only for issued policies ▪ Commission on portability ▪ PAN and Bank Account updation ▪ Commission Claw Back ▪ Long outstanding commission ▪ Commission Computation ▪ Commission Payment ▪ Commission Accounting
10	Reinsurance	<ul style="list-style-type: none"> ▪ Reinsurance Treaties ▪ Reinsurance rates masters creation and modification ▪ Reinsurance Premium Ceded Computation ▪ Reinsurance Claims ▪ Reinsurance Accounting

Sr. No.	Areas	Critical Aspects
Core Business Function		
11	Claims - Individual/ Group/ Survival \$ Maturity Benefit	<ul style="list-style-type: none"> ▪ Claims Intimation and Registration ▪ Claims Processing ▪ Further Requirements ▪ Claims Investigation ▪ Delays in settlement ▪ Claims Payments ▪ Statutory Records ▪ IRDA reporting ▪ Claims Accounting
12	Investments (Front / Mid and Back Office)	<ul style="list-style-type: none"> ▪ Segregation of Duties (FO/MO/BO) ▪ Deals Requisitions ▪ Investment Policy ▪ Dealing Room Controls ▪ Exposure and Prudential Norms ▪ Broker's Empanelment ▪ Prevention of Insider Trading ▪ Credit Risk & Market Risk ▪ IRDAI Investment Returns/ Statutory Reports and MIS ▪ Fund Accounting
13	Incentives	<ul style="list-style-type: none"> ▪ Incentive Scheme Design ▪ Incentive Computation ▪ Incentive Payments ▪ Incentive Accounting

AREAS TO BE COVERED IN IFC (Insurance Industry)

Sr. No.	Areas	Critical Aspects
Accounts and Finance		
14	Financial Closure and Reporting	<ul style="list-style-type: none"> ▪ Related Party Transaction ▪ Bank Reconciliations ▪ Recording of Prepaid Entries ▪ Recording of Provision Entries ▪ Recording of Expenses ▪ Vendor Creation ▪ Recording of Payments ▪ Payment to Vendors ▪ Financial Reporting ▪ Master Circular Compliance ▪ Segmental Reporting ▪ Allocation of operating expenses ▪ Disclosures ▪ Contingent Liabilities ▪ Accounting Standards ▪ Change in Accounting Standards ▪ Issuance of Share Capital ▪ Statutory Dues ▪ Preparation of Returns ▪ Advance tax computation and payments ▪ Income tax computation ▪ Fixed Asset Accounting and Depreciation

Sr. No.	Areas
Support and Other Functions	
15	Policy Servicing
16	Outsourcing of Activity
17	Legal
18	Board & Secretarial
19	Persistency
20	Procurement
21	Advertisement
22	Marketing
23	Human Resource and Payroll
24	Customer Service

5. ILLUSTRATIVE IFC RCM

Investment Function



Microsoft Excel
Worksheet

6. ENTITY LEVEL CONTROLS

ENTITY LEVEL CONTROLS

Entity level Controls shall include the following critical areas which sets the “Tone at the top”:

- Fraud Control Framework and Anti Fraud Policies.
- Code of Conduct and Ethics.
- Whistle Blower Policy.
- Board Committees (Formulation/Meetings, etc.)
- Corporate Governance.
- Internal Audit Function.
- Management Controls over various departments.
- Communication with Regulators.

7. INFORMATION TECHNOLOGY GENERAL CONTROLS (ITGC)

INFORMATION TECHNOLOGY GENERAL CONTROLS

ITGC to include Risks and Controls for the below mentioned general areas:

- IT Policies and Procedures.
- User Management.
- Change Management.
- Incident Management.
- Data Back up.
- BCP/ DRP.
- Information Privacy & Security.

8. DASHBOARDS - For Management and Audit Committee Presentation

DASHBOARDS

Risk & Control Coverage Overview

Illustrative

Sr. No.	Areas	Total Number of		No. of Control Failures	No. of Observations		Material Impact (Y/N)
		Risks	Controls		Design	Operating	
I	Entity Level Controls	67	67	2	5	8	
II	Process Level Controls						
1	Premium Collection Accounting and Reconciliation	40	53	-	-	-	
2	Commissions Calculation, Accounting & Payment	35	39	-	13	-	
3	Investment - Front Office	14	14	-	4	-	
4	Investment - Mid and Back Office	38	41	-	6	-	
5	Financial Reporting and Taxation	81	89	1	4	1	
	etc.						
III	ITGC	23	23	1	7	2	
	Total	907	991	6	85	28	

DASHBOARDS

Observations and Recommendations Overview

Illustrative

Sr. No.	Areas	Design Recommendations			Operational Effectiveness Recommendation	
		Key Controls	Policy/ SOP Formulation	Good To Have Controls	Strengthening Documentation	Strengthening operational efficiency
1	Premium Collection Accounting and Reconciliation					
2	Commissions Calculation, Accounting & Payment					
3	Investment - Front Office					
4	Investment - Mid and Back Office					
5	Financial Reporting and Taxation					
	etc.					
Grand Total						

DASHBOARDS

Executive Summary of Key Observations

Illustrative

Sr. No.	Risk Description	Existing Practice	Recommendation
1	Absence of SOP/Manual documentation.	There is no SOP or manual documented defining the process, roles and responsibilities, for the following areas: <ul style="list-style-type: none"> - Product Pricing - Product Development & File and Use - Legal - Board & Secretarial - Persistency - Advertisement - Impairment Policy 	It is recommended to have a well defined SOP/Manual for the operation of the department and review the documentation on periodic intervals.
Entity Level Controls			
1	The internal policies do not establish minimum standards of conduct for attainment of its Compliance Objectives.	Certificate of Corporate governance duly certified by compliance officer forms a part of Annual Report.	It is recommended that department head provide quarterly certification on compliance to relevant laws so that deviation/ non-compliance(if any) are reported on a quarterly basis.
2	The scope of planned internal audit activities are not reviewed in advance with: Senior management, Board of directors or audit committee, Independent auditors.	Scope, Functioning, Periodicity and methodology for conducting internal audit of LIC of India is documented and approved by Board.	It is recommended Audit plan to be also presented and approved in the Audit Committee Meeting on a annual basis.

9. CHALLENGES AND CONSULTANT'S PREPARATION

CHALLENGES AND PREREQUISITES

The following may be some of the challenges faced in delivering IFC project in Insurance Industry and the preparation required by Consultants:

➤ **Regulatory Environment:**

The Industry being regulated with numerous regulations, guidelines, circulars by IRDAI, the **IFC Consultant / Auditor need to be appraised of the regulatory environment and knowledge of the regulations.**

➤ **Insurance Business:**

Considering the different processes in Insurance Industry, the **IFC Consultant / Auditor need to an understanding of Insurance business to deliver a justifiable IFC project.**

➤ **Time Involvement and Team:**

For a comprehensive IFC in Insurance Industry, multiple discussions with some 50 process owners needs to be conducted, **IFC Consultant / Auditor shall according estimate the efforts and time involvement.**

THANK YOU

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