

Pakistan Insurance Institute

# **INTERNAL AUDIT - GENERAL INSURANCE**

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# **Brief Profile: - Nawaid Jamal**

- ❑ Qualified Chartered Accountant (FCA) working in Pakistan Insurance Industry for last fifteen years.**
- ❑ Chief Financial Officer of one of the Top 3 General Insurance Company of Pakistan for last five years.**
- ❑ Worked with Deloitte Bermuda and Bahrain, mostly involved in audit of insurance companies.**
- ❑ Elected Member of IAP Executive Committee.**
- ❑ Actively involved in Taxation Legislation and Regulations matters of General Insurance industry as member of IAP Taxation Sub Committee.**
- ❑ Member of Taxation – Sub Committee of Karachi Chamber of Commerce & Industries.**
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# INTRODUCTION

- Internal auditing is an independent, objective assurance and consulting activity designed to add value to and improve an organization's operations.

It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

The role of internal audit is to provide independent assurance that an organization's risk management, consistency and internal control processes are operating effectively.

# OBJECTIVES

- ❑ To review, analyze and appraise the adequacy and effectiveness of the system of internal controls concerning the accounting, financial and operating activities of the Company.
- ❑ To ascertain the extent of compliance with the established policies, plans, procedures, instructions and regulatory requirements.
- ❑ To ascertain the extent to which the Company's assets are accounted for and safeguarded from expected loss.
- ❑ To design activities to add value and improve Company's operations.
- ❑ To ascertain the reliability of accounting and other data generated within the Company.

## **Disclaimer:**

The review and appraisal of the system of internal controls and the policies and procedures of the company, by the Internal Audit Department and the adoption of their recommendations will not, however, relieve other persons in the Company of their responsibilities in this regard.

# FACTS OF INTERNAL AUDIT

The double-entry bookkeeping system invented in the 13th century provided the means for those engaged in commerce to control transactions with suppliers and customers and check the work of employees (i.e. - the first internal controls.)

- ❑ Historical records suggest that internal auditors were being utilized prior to the 15th century. These auditors, employed by kings or merchants, were charged with detecting or preventing theft, fraud, and other improprieties.
- ❑ As industry and commerce evolved, so did control methods and audit techniques. These methods migrated to the United States from England during the industrial revolution. Managerial control through auditing continued to gain favor up to and through the 20th century.
- ❑ In 1941, The Institute of Internal Auditors (IIA) was founded in New York City, USA, by a small group of practicing internal auditors. The group recognized that they had many commonalities in the way they worked despite the fact that they worked in different businesses and industries.
- ❑ The internal audit profession evolved steadily with the progress of management science after World War II. Much of the theory underlying internal auditing is derived from management consulting and public accounting professions.
- ❑ With the implementation of the U.S. Sarbanes- Oxley Act of 2002, the profession's growth accelerated as internal auditing became more visible, more respected, and more valued.

# ROLE OF INTERNAL AUDITORS

- ❑ **Adding Value** - Ask yourself, “How is the department adding value?” and “How are you adding value?” Value proposition is a critical, keystone element of what and how this will serve an organization.
- ❑ **Beyond Effectiveness** - Board and audit committees are seeking deeper insights into risk management, beyond just controlling effectiveness.
- ❑ **Extending Risk** - Vision and objectives of an audit function need to extend to risk identification and risk mitigation and continue to expand coverage to strategic risks.
- ❑ **Don't Neglect the Old**- While attempting to expand, don't forget to maintain your current compliance areas! Avoid any decrease in coverage on financial reporting, operational, and other compliance related areas.
- ❑ **Break the Wall** - Internal audit is often seen as the internal police. Internal audit should build the bridge to be a real business partner, while still remaining independent. It takes a great deal of collaboration with management to achieve business goals and internal audit objectives. This in turn will provide a return on value beyond just compliance effort.

# MYTHS OF INTERNAL AUDIT

- ❑ Myth 1: Internal auditors are "bean counters" just like the accountants.
- ❑ Myth 2: Auditors are nitpickers and fault-finders.
- ❑ Myth 3: It's best not to tell the auditors anything unless they specifically ask.
- ❑ Myth 4: Internal auditors follow a cycle in selecting their audit "targets" and use standard checklists so they can audit the same things the same way each time.
- ❑ Myth 5: Internal audit is the corporate "police function."

# RISK BASED INTERNAL AUDITING (RBIA) STRATEGY

- ❑ The objective of the process risk assessment exercise is to prioritize areas for audit within the organisation.
  - Determination of Likelihood and Impact (**High, Medium, Low**) of risks involved in the processes.
  - Subsequent determination of Overall Combined Risk Assessment (CRA).
  - Based on assessment, High Risk areas / processes / dept. should be covered for audit every year at each location, whereas the Medium and Low Risk areas / processes /depts. could be covered for audit on rotation basis.
  
- ❑ Internal audit to provide the board with assurance that it needs on three areas:
  - Risk management processes, both their design and how well they are working,
  - Management of those risks classified as 'key', including the effectiveness of the controls and other responses to them,
  - Complete, accurate and appropriate reporting and classification of risks.



# PREMIUM / REVENUE CYCLE AUDIT

- In order to understand the Audit of a cycle, we need to understand the risks that exists in the processes and what controls are in place to minimize those risks.
- Areas needs to be given special attention during the audit :
  - Underwriting Policies & Procedures
  - Risk Inspection
  - Segregation of duties
  - Refund / Cancellation Endorsements
  - Compliance of Rule 58
  - Cover Notes
  - Conversion of Marine Cover Notes
  - Compliance of audit & Surety Rules

# Exercise A (Duration 5-7 minutes)

➤ Section 99 (4) of the Insurance Ordinance, 2000 states as follows:

" It shall be unlawful for an agent to deduct from premium paid by and received from a policy holder any sums on account of commission due to agent "

- Your Insurance Company actively operate and generate significant premium from Cotton Belt (area from Hyderabad till South Punjab). The established norm of this area to make the premium payment after deduction of agreed commission. Other insurance companies along-with your insurance Company following the same practice. Being a responsible Internal Auditor your recommendations to the management of your company will be one (or more) of the following:
  - Stop underwriting all such kind of business and get away from one important segment of the insurance market
  - Interpret law differently and advise to continue underwriting such business
  - Educate the client that we all are responsible citizen of the country and we must follow the law (chances of client understanding are remote)
  - Discuss with other market players in insurance market to form an alliance for refusal by all insurance companies to refuse issuance of insurance policies to all ginnners operating in that particular market.
  - Other (Please specify)

# CLAIMS CYCLE AUDIT

- Areas of special attention during the audit:
  - Defined Roles and Responsibilities / Segregation of duties
  - Completeness of claims intimation
  - Procedure of setting outstanding claims reserves
  - Turn around Time (TAT)
  - Level of Automation of process
  - Taxation compliance
  - Role / Quality of loss adjuster

# REINSURANCE CYCLE AUDIT

- Areas of special attention are as follows:
  - Process of Reinsurance / Procedures etc.
  - Selection of Reinsurance Company / Broker
  - Reinsurance Strategy
  - Reinsurance Recovery / PRCL
  - Taxation & Regulatory Compliance

# COMMISSION & AGENCY CYCLE AUDIT

- Areas of Specific attention are as follows:
  - Selection of Agents / Marketing Officers
  - Performance Review Process
  - Standard Commission and overriding Commission
  - AFC Compliance
  - Change of Agency after issuance of insurance Contract.

# FINANCIAL STATEMENTS / FINANCE CYCLE

- Provision for IBNR
- Impairment for AFS Investments
- Provision for doubtful Premium / Age Analysis
- Written off Doubtful debts / other Assets.
- Related Party Identification / Arm's Length transaction.
- Bank Reconciliation
- Solvency Ratio
- Financial Strength (Credit Rating)

# AUDIT WORLD

**What's an auditor?**

*Someone who arrives after the battle and bayonets all the wounded.*

**Did you hear the joke about the interesting internal auditor?**

*No, Me neither*

**Who checks compliance in Hell?**

*The Infernal Auditors.*

**What should you call an auditor who doesn't have an opinion?**

*I have no idea*

**Why did the auditor cross the road?**

*Because that was written in the last year file.*

**Thank You**