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The Model Audit Rule—It's Not SOX, But It Has a Punch!

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Although not as cumbersome as compliance with the Sarbanes-Oxley Act of 2002 (SOX), the National Association of Insurance Commissioners (NAIC)'s Annual Financial Reporting Model Regulation (the Model Audit Rule or MAR) does require significant effort on the part of companies. In addition, the deadline for compliance with MAR is quickly approaching. Hopefully, your company has rallied the troops and begun to take action to comply with the new MAR. If some version of a "MAR Readiness Plan" has not already been developed and begun its initial execution phase in your company, time could be running short. But don't panic. How your company approaches MAR could make implementation less painful than you might expect.

Compliance with MAR has several deadlines, beginning with the requirements over auditor independence and corporate governance (such as audit committee independence), which were effective Jan. 1, 2010. The most time-consuming of the MAR requirements—management's report of internal control over financial reporting—is effective with the reporting period ending Dec. 31, 2010, with the first report due to the state insurance department on Aug. 1, 2011.

This internal controls report requirement, sometimes referred to as SOX-Lite, requires management of insurance companies with $500 million or more in direct and assumed premiums (and certain RBC thresholds) to file a report with the state insurance department regarding the insurance company's assessment of its internal control over statutory financial reporting. The report, among other things, includes management's assertion regarding the effectiveness of internal control over financial reporting to the best of its knowledge and belief after diligent inquiry. Additionally, unlike SOX, the external auditors are not required to opine on management's process. These two areas afford insurance companies flexibility in their approach to compliance with MAR. It is important to note that a SOX compliant company can file its SOX Section 404 report including an addendum on material elements of the statutory accounting process.

With the deadline just around the corner, company management should focus on a streamlined sustainable approach tailored specifically to their organization. Consultants can provide valuable insight and structure to your company's MAR project, but be careful of the SOX-experienced consultant with a one-size-fits-all approach. This is the time to incorporate some "out of the box" thinking in crafting your MAR implementation plan. Insurance companies should consider the following as they develop their tailored approach to MAR compliance:

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- Involve the appropriate company personnel in the process and establish process owners. Support from top management is essential. Additionally, process owners in all significant areas such as actuarial, investments, claims, premiums and information technology must be involved.
- Assess accounts/processes using both quantitative and qualitative measures when reviewing accounts/processes for materiality. The materiality that you use is not strictly a quantitative measure.
- Focus on the high risk areas first. Management must only report on those controls not remediated by Dec. 31, 2010, so identifying and testing controls in high risk areas is imperative to minimize unremediated material weaknesses reported at year-end.
- Use a centralized repository for control documents. Review and evaluation of results and deficiencies will be streamlined. Additionally, custom reports can be created from the centralized repository to assist you in all review and monitoring efforts.
- Develop realistic remediation plans and implementation strategies based on risk and available resources. Unrealistic expectations without buy-in from management and process owners are doomed to fail.
- Utilize SAS 70 reports to your advantage. An SAS 70 is an independent comprehensive assessment (under AICPA standards) of internal controls over business processes. Take advantage of the ones you issue and those issued by your vendors. Some typical areas include general computer controls and controls related to claims processing.
- Take advantage of SOX efforts within your organization. Keep in mind, however, that SOX is for financial statements prepared in accordance with generally accepted accounting principles (GAAP), while MAR relates to those statements prepared in accordance with statutory accounting principles. This means that if you have already documented and tested key controls for your GAAP reserves, your statutory reserving methodologies will now need to be addressed.
- Ensure that you have a comprehensive understanding of the permitted practices surrounding aggregation of affiliates.
- Obtain input from your external auditors but do not let them dictate the project.
- Utilize the assessment of controls on financial reporting requirement as a positive. Audit your financial models for accuracy and implement efficiencies in the results analysis and reporting processes.
- Establish a monitoring process for continued evaluation and compliance in subsequent years. Create a steering committee that includes management to keep track of progress.
- Integrate the monitoring process into the day-to-day operations and over the internal control environment of your organization. Opportunities for efficiencies with other projects and requirements exist if the importance of maintaining controls for operations is emphasized over a single compliance focus.

1. Management's statement on internal controls is based upon diligent inquiry which provides for flexibility in the company's approach.
2. Adopt a risk-based approach. Focus truly on those risks that impact financial reporting and financial statements and stay away from the "other" transactional controls. This is the time to incorporate some "out of the box" thinking in crafting your MAR implementation plan.

Even though a creative customized and tailored approach to MAR can streamline the compliance process, implementation issues are sure to arise. Areas such as educating top management on the MAR requirements and obtaining their support, educating and establishing process owners, establishing a method of continuous evaluation and communication of updates of key controls, and developing and adhering to the strict timeline all take time and resources which can put additional strains on the already stressed smaller insurance company. However, it is critical for these companies to focus on the fact that MAR is not SOX; it's SOX-Lite. Have the confidence to buck the early trends of those companies who began implementing their MAR project plan years ago. Tendencies have been to turn MAR compliance into an intensive undertaking and draining "here we are on day one of SOX" type effort. Comprehending the flexibility inherent to MAR over SOX is key to achieving a successful and streamlined implementation. Application of diligent inquiry and the utilization of a top-down, risk-based approach are critical concepts in uncovering and incorporating that flexibility. With an appropriate understanding of MAR, a path to a successful and timely implementation does exist. But don't delay. Now is the time to start. ●

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