Model Audit Rule: Lessons learned from Implementation, Examination and Audit



Meet your presenters



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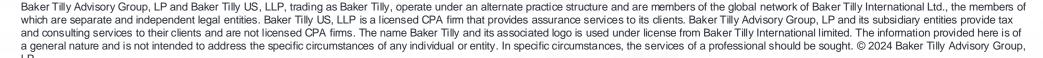
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Today's topics

Understand the Model Audit
Rule (MAR): Gain a
comprehensive understanding
of the internal control over
financial reporting requirements
under the Model Audit Rule
(MAR) for insurers.

Identify Key Regulatory
Compliance Requirements:
Recognize the key compliance
requirements for insurers
approaching or exceeding
\$500M in direct and assumed
written premiums.

Prepare for MAR
Implementation: Learn the necessary steps to implement an effective MAR program, ensuring alignment with regulatory expectations and industry best practices.

Optimize Existing MAR
Programs: Explore strategies
for evolving and optimizing an
existing MAR program to
enhance organizational value.

Align MAR Programs with Organizational Strategy:

Define and align MAR program objectives with the broader goals of the organization for a strategic approach to compliance.

Discuss Industry Trends and Lessons Learned: Review industry trends, lessons learned, and common misconceptions regarding MAR implementation and evolution. Takeaways for Different
Stages of MAR: Identify key
takeaways and considerations
for insurers at various stages of
their MAR journey, from initial
implementation to program
maturation.

Polling results from our last MAR webinar

What trend do you think will have the greatest impact on MAR compliance in the next three to five years?

- a) Automation of controls enabling reduction in sample requirements 19%
- b) Continuous monitoring and additional use of computer-assisted audit techniques 17%
- c) Unforeseen changes to regulatory requirements 5%
- d) Additional leverage of department resources to fulfill requirements 3%
- e) All of the above **50%**

What trend has the greatest impact on the efficiency and effectiveness of your MAR program?

- a) Self-assessments 18%
- b) Utilization of a GRC system **9%**
- c) Use of third-party consultants to assist **11%**
- d) Improved project management 18%
- e) Rotational auditing 20%

What is your top challenge with maximizing the efficiency and effectiveness of your MAR program?

- a) Not maximizing reliance by our external auditor resulting in duplication of effort 4%
- b) Obtaining support from department personnel to take on the requirement of testing instead of a dedicated internal audit/compliance/SOX group 15%
- c) Identifying the "right amount" of key controls, as we have more key controls than we probably need -26%
- d) All of the above 34%



Model Audit Rule requirements

Where are you in your MAR journey?

- a) In the beginning stages of learning about MAR but do not have to be MAR compliant in the next few years
- b) Planning for MAR compliance implementation within the next one to three years
- c) Currently MAR compliant and always looking for ways to improve
- d) Currently MAR compliant, but may need to be SOX compliant in the next few years
- e) None of the above
- f) Not applicable

Model Audit Rule – summary of requirements

Applicable model

Annual Financial Reporting Model 205

Section 17 – Management's Report of Internal Control over Financial Reporting Annual attestation on internal control

Purpose

To provide regulators greater confidence in accuracy of financial reporting

Increase efficiency of risk-focused examinations

Increase management's confidence in internal controls

About the report

Statement that management is responsible for establishing and maintaining internal control

Statement that management has established internal control and whether management believes that internal control is effective

Brief description of the approach used to evaluate effectiveness

Scope of work and any excluded controls

"Bridge report" required for SOX compliant issuers

Disclosure of any unremediated material weaknesses in internal control as of Dec. 31, 20XX

Statement regarding any inherent limitations of internal control

Signatures of the CEO and CFO

Applicable threshold and filing timeline

Threshold: Direct written and assumed premium equal to or greater than \$500 million

Filing: Typically 60 days after Audited Financial report is filed, at the latest Aug. 1, with the exception of NYDFS that requires submission by May 31

Auditor and SOX attestation

- Independent audit attestation is not required. The auditor is required to disclose unremediated material weaknesses in a filing to the commissioner
- Can leverage SOX attestation. Still have to file SOX report, but include an addendum stating all MAR internal controls were included in scope of SOX report

Effective dates

Two calendar years from exceeding the threshold

		_		
\$ millions	201x	201x+1	201x+2	201x+3
Net (written) premiums, per	350.3	390.8	410.5	425.7
Statement of Operations in Audited			/	
financial report				
Add: Reinsurance ceded	100.5	115.7	115.8	120.1
Gross direct written and assumed	450.8	506.5	526.3	545.8
premium				

Exemptions and waivers

- Carriers under \$500M are exempt from requiring but the commissioner has authority to require compliance
- Hardship waiver is available, must determine reasons for hardship under section 17 (18), contact your financial analyst, file a written application for waiver, and receive approval for exemption (usually a year)

MAR overview

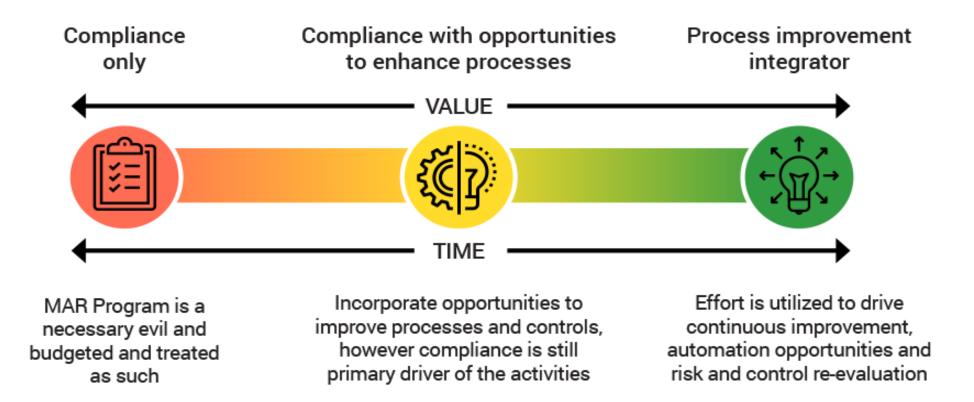
Management's responsibility for diligent inquiry:

- Section 17D(2) states that management's assertion regarding the effectiveness of the insurer's financial reporting controls must be made to the best of their knowledge after diligent inquiry
- Defining diligent inquiry according to the Model Audit Rule implementation guide:

For purposes of filing the report, **diligent inquiry** means conducting a search and thorough review of relevant documents which are reasonably likely to contain significant information with regards to internal control over financial reporting and making reasonable inquiries of current employees and agents whose duties include responsibility for internal control over financial reporting

Industry perspectives and viewpoints

Company perspectives and a tale of two clients:



Industry perspectives and viewpoints



Regulator:

- Adequacy of MAR is addressed during examinations
- Material weakness identification is followed up on when reported. May result in an increase in priority scoring



External audit:

- Not required to report on the effectiveness of internal controls/MAR program
- Most auditors (non-SOX companies but large insurance groups) exhibit the following:
 - Use of internal audit/MAR team members for direct assistance
 - Rely on controls for some key areas, set control risk to maximum in critical areas
 - Use MAR documentation to assist within the audit but it doesn't create significant efficiencies due to increased scrutiny on control reliance

Implementation roadmap summary

New implementation roadmap

Summary			
Company (State of Domicile)	Year End Expected to Breach \$500M	Year-end MAR Certification Required	Filing of Certification Deadline
Company	202X	202X+2	7/31/202X+3





Conduct a scoping, materiality and risk assessment exercise to document required areas and processes subject to MAR.

Forecast and identify the year the domiciled entity will breach \$500 million in premiums per the domiciled State adoption of the Model Audit Rule 205 regulation

Q2-Q3202X



Conduct a gap analysis of the current state processes. Conduct a remediation plan and identify key process owners and accountable timeframes for implementation.

Q3 202X-Q3 202X+1



Develop required documentation of key controls for process areas and functions in scope. Conduct initial testing and remediation as necessary.

Project management and ongoing

change management

Execute on required MAR control identification, testing, remediation and internal reporting to key process owners and executive management.

July 31, 2024 x3



Document certifications by process owners and summarize results for the CEO and CFO. Submit the Certification to the Insurance Department no later than July 31, 202X+3

Continue to adapt and refine your MAR scope, approach and identify value drivers and challenges

Key considerations to effective implementation

Consideration **Action Value** Senior management and audit committee understanding, training and Tone from the top and bottom up Governance certification drives accountability Incorporate functional area certifications to provide to the CEO and CFO and commitment prior to certifying • Identify a MAR champion for each functional area. The champion Failures and inefficiency occur doesn't have to be the key process owner when there is lack of accountability • Ensure training is conducted annually. Request feedback on training **People** and understanding. Self needs assessments reduce costs and • Explore the use of self assessments. The process should be guided by someone independent of the function increase awareness · Revisit risk assessment and materiality scoping. Incorporate a subledger Too many companies "over audit" materiality to reduce accounts in scope. Have clear explanations for and spend more hours/resources reason for exclusions than necessary in lower risk areas. Implement a MAR calendar of kickoff meetings, testing timeline and **Process** deliverables and make all affected parties aware Having strong project management Conduct rotational auditing rotation by risk, functional area or a assists with cost reduction and combination increased effectiveness Incorporate MAR testing as part of other audits for efficiency Utilization of technology will drive Incorporate the use of dashboards and analysis of key controls and deficiencies overall FTE assistance by IA or Third party cloud-based governance risk and compliance software MAR specific team down. Further, it **Technology** integration should reduce follow-up and Identify bottlenecks and cost drivers and incorporate continuous increase overall effectiveness identification of opportunities to automate controls

How many hours/Full time equivalents (FTEs) do you dedicate to your MAR compliance efforts annually?

- a) None, we haven't started implementation yet
- b) 501 1,500 (1 FTE or less)
- c) 1,501 3,000 (2 FTEs)
- d) 3,001 4,500 (3 FTEs)
- e) 4,500+ (4 FTEs+)
- f) Unsure
- g) Not applicable

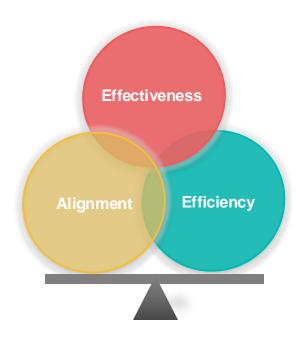
Considerations in addressing requirements for the basis for management's review and assertions

What is your top challenge in maximizing the efficiency and effectiveness of your MAR program?

- a) Identifying the "right amount" of key controls, as we have more key controls than we probably need and may be missing others
- b) Time of resources (internal audit, MAR team, business owners, etc.) to dedicate to improving the existing processes
- c) Being viewed by business owners as a compliance exercise
- d) People and change management, the lack of ability to change resulting in doing things "the same old way"
- e) None of the above
- f) Not applicable

MAR CONSIDERATIONS

Business process



Key considerations include balancing effectiveness, efficiency and alignment to optimize their financial reporting and internal control assessment efforts

Alignment

- Risk analysis
- Materiality scoping

Efficiency

- Rotational auditing
- Self-assessments
- State examination/NAIC risk matrix approach

Effectiveness

- Key control and compensating control assessments
- Proper deficiency evaluation
- Dashboards, understand broader impact of results

Business process alignment

Alignment

- Risk analysis
- Materiality scoping



Revisit financial statement level risk analysis annually

Risk mapping

Align key risks to management assertions, remove/add risk and controls as needed



Risk-based approach to addressing management assertions

Materiality and scoping

Consider using state regulators benchmark if appropriate

5% of surplus for planning materiality



Apply subledger materiality

Set a % of GL account and >= \$ amount



Management judgement

Apply a qualitative judgement score

Areas of audit weakness or strength

Areas of emerging risks

Business process efficiency

Efficiency

- Rotational auditing
- Self-assessments
- State examination/NAIC risk matrix approach

Ex. A - Claims administration			
Risk	Risk assessment	Key control	Test frequency
Risk A	High	CLM1 – monthly	Annually
Risk B	Low	CLM2 - quarterly	Every two years

Ex. B - Function	Risk assessment	Testing frequency
Claims and benefits	High	Annually
Policy loans	Moderate	Once every three years (self assessment)

Rotational auditing

- Risk-based within the functions (Ex. A)
 - Should reduce key control testing requirement but may require more support and explanation
- Function based on risks results (Ex. B) more common
- Combination would have largest efficiency impact, but may require more administration to track

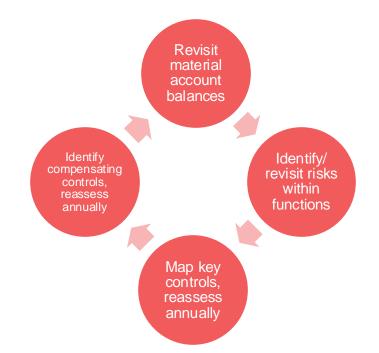
Self-assessments

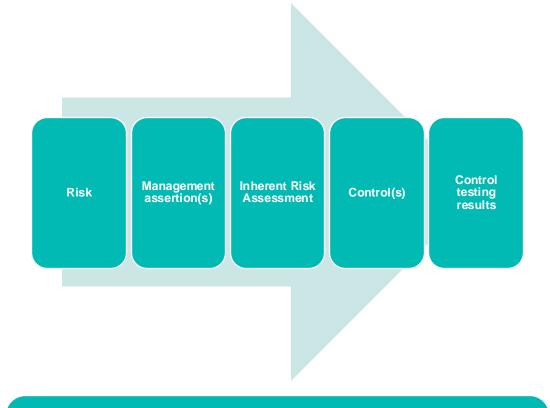
- Guided process
- Initially lower risk areas
- Rotational
- Internal audit verification
- Limit retention of documentation

Business process effectiveness

Effectiveness

- Key control and compensating control assessments
- Proper deficiency evaluation
- Dashboards, understand broader impact of results

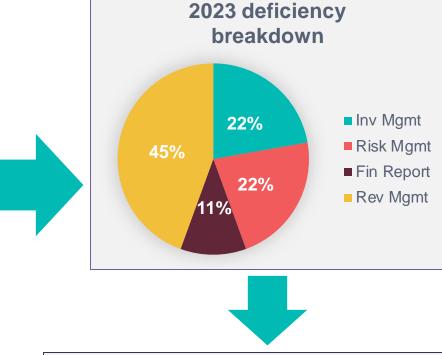


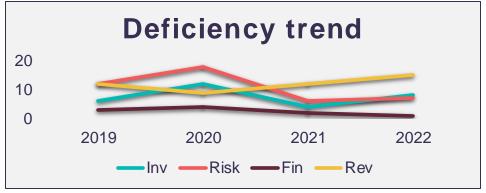


Set up and identify risks and controls in line with NAIC matrix approach. Consider speaking the same language as state regulators – which may also lead to a more efficient exam as well

Business process effectiveness

Function	Strategic function
Bond portfolio administration	Investment
Stock portfolio administration	management
Treasury	
Enrollment	Risk management
Claims administration	
IBNR and medical liabilities	
Tax accounting	Financial reporting
STAT reporting	
Provider incentives	Revenue
Pharmacy rebates	management
Member premium billing	





Information technology considerations and viewpoints

Information technology (IT) - scoping considerations

IT governance

- Policies and procedures
- People
- •Role of executive management and those charged with governance

Access control

- User access provisioning/deprovisioning and review
- Segregation of duties
- Security administration
- Elevated privileges
- Access review
- Physical security access and monitoring

Change management and SDLC

- Planning
- Development
- Testing
- Approval
- Production
- Segregation of duties and environments

Contingency planning

- Backup and restore processes
- •Recovery: Disaster Recovery and Business Continuity
- •Response: Incident Response and Crisis Management

Security operations

- •Network security: IPS/IDS, FW
- Encryption solutions
- Monitoring and alerting solutions: SIEM, network performance, DLP, endpoint
- •Vulnerability management: scanning, patching

IT operations

- System integrations
- Job scheduling and monitoring
- Environmental controls

Vendor management

- Planning
- · Due diligence
- Contracting and onboarding
- Monitoring: performance, strategy/financial, information security
- Termination

Training and awareness

- Technical training
- Security awareness and reinforcement
- Anti-phishing

Data governance

- Key report management
- · Data flow mapping
- Data intake, sharing and processing

Asset management

- Inventory
- Configuration management
- Acquisition, maintenance and disposal
- Record retention and destruction

IT efficiency AND IT effectiveness

Risk-based IT system scoping

- Volume of users
- On premise vs hosted
- Volume of transactions
- Financial impact
- Level of automation/controls
- Down stream detective controls

Identify automated controls

- Business process
 - Field edits
 - Data validation process errors
 - Exception/anomaly reporting
 - Disbursement authority
- Information technology (IT)
 - Backup failure reporting
 - Segregation of duties
 - Role-based access
 - Access provisioning automation

Leverage other assessments

- Internal Audit
- SOC examinations
- HITRUST
- ISO
- NIST CSF
- Etc.

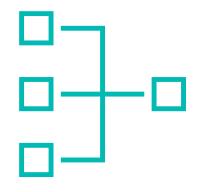
Completeness and accuracy

- IPE Information Provided by the Entity
- Key reports
- Enables reliance and/or re-performance
- Identify issues and assess impact
- Accuracy of control performance (e.g., use of scripts to identify period over period permission changes within applications)



IT systems scoping considerations

System identification



- On premise
- Hosted solutions
- Web applications

System assessment



- Financial impact material financial statement line items
- Mapping of systems to financial statement line items
- Relevant risks to key systems

Other considerations



Data governance and integrity

Questions?

Stay in touch



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For more information on these topics, check out https://www.bakertilly.com/specialties/model-audit-rule









