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THE NEW ROLE OF AUDIT COMMITTEE AND CONCEPT OF INTEGRATED AUDIT programme IN INSURANCE UNDERTAKINGS AND REINSURANCE UNDERTAKINGS

1. Introduction

The issues related to internal and external supervision in financial institutions have been the area of interest of a variety of international organizations for more than 30 years. At present financial supervision authorities in UE and Poland are trying to increase the effectiveness of internal and external supervision in insurance sector institutions (insurance undertakings and reinsurance undertakings). It was not until 2009 that works were completed on a draft of a new solvency regime which was set out in detail in Directive *Solvency II* on the taking-up and pursuit of the business of Insurance and Reinsurance.

Insurance sector institutions must now take appropriate measures to adapt the internal supervision to the new regulations. Recent legislative amendments in Poland, however, imposes a set of formal obligations on institutions, requiring them to set up an audit committee to assess the institution's internal control and risk management systems, and supervise internal audit activities, if an appropriate function has already been established in the institution. Audit committees, internal audit, internal control system, as well as external audit and financial supervision currently constitute key elements of corporate governance and monitoring of activity in insurance sector institutions². In Poland, insurance sector institutions have

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² E.I. Szczepankiewicz, *The role and tasks of the Internal Audit and Audit Committee as bodies supporting effective Corporate Governance in Insurance Sector Institutions in Poland*, *Oeconomia Copernicana* 2012 nr 4, Uniwersytet Mikołaja Kopernika, PTE, Toruń 2012, s. 24.

also been gradually adopting regulations governing such issues as roles of the audit committee, establishment of internal control systems and internal audit functions.

The purpose of the present article is to discuss the roles, function and tasks of audit committees as the bodies supporting effective supervision in Polish insurance sector institutions³. The first section describes the impact of the amendment of regulations on the development of the present internal supervision in insurance sector institutions. The next part presents the roles, purpose, function and tasks of audit committees and on the author's concept of integrated audit programme in insurance sector institutions. Research method adopted in the study is to analyze the most important regulations of internal supervision and inference.

2. The internal supervision in insurance sector institutions according to international and Polish regulations

In Europe the basic issues in corporate governance in insurance sector institutions are governed, inter alia, by the EU Directives:

- Directive 2006/43/EC it made the assessment of internal control systems and the appointment of audit committees in public interest institutions mandatory⁴,
- Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (*Solvency II*)⁵,
- Directive 2013/34/UE (amended Directive 2006/43/EC) regulates the obligations of assessment of internal control systems and the tasks of audit committees in public interest institutions mandatory.

It needs to be stressed that the standards for institutions insurance sector down by the International Association of Insurance Supervisors (inter alia Standard No. 2.2.6. on Enterprise Risk Management for Capital Adequacy and Solvency Purposes and other)⁶. This Association develops standards in conformity with recommendations issued by the Basel Committee on Banking Supervision (BCBS) and internationally recognized internal control standards (such as Report of COSO⁷

³ Artykuł powstał w ramach realizacji projektu z badań statutowych Uniwersytetu Ekonomicznego w Poznaniu nr 51102-142 w 2015 r. „Wpływ światowych regulacji na zmiany w rachunkowości i audycie w jednostkach zainteresowania publicznego”.

⁴ Dyrektywa 2006/43/WE Parlamentu Europejskiego i Rady z 17.05.2006 r. w sprawie ustawowych badań rocznych sprawozdań finansowych i skonsolidowanych sprawozdań finansowych (...), (Dz. Urz. UE L 157/87 z 09.06.2006, ze zm.).

⁵ Dyrektywa 2009/138/EC Parlamentu Europejskiego i Rady z dnia 25 listopada w sprawie podejmowania i prowadzenia działalności ubezpieczeniowej i reasekuracyjnej (*Solvency II*) (Dz. Urz. L 335, z 17.12.2009).

⁶ Standard No. 2.2.6. on Enterprise Risk Management for Capital Adequacy and Solvency Purposes, International Association of Insurance Supervisors 2008, www.iaisweb.org, (10.03.2011).

⁷ Report of COSO: Internal Control – Integrated Framework (1992, 1994), Committee of Sponsoring Organizations of the Treadway Commission, USA, www.sox-online.com/coso_cobit.html, (10.03.2011).

and COSO II⁸) published by The Committee of Sponsoring Organizations of the Treadway Commission (COSO), as well as international internal auditing standards published by The Institute of Internal Auditors (IIA)⁹.

In addition to compliance with appropriate EU Directives and Standards, institutions insurance sector operating in individual states must mainly conform with national regulations. The insurance sector institutions operating in Poland today are obliged to comply with a significant number of revised national laws, including:

- 1) the Act on the Insurance Activity (2003, as well as amendments 2010, 2013, 2014)¹⁰,
- 2) the Act on the Financial Market Supervision (2006)¹¹,
- 3) the Act on Statutory Auditors and on the Public Supervision (2009)¹²,
- 4) resolutions of the Polish Financial Supervision Authority¹³.

The Act on the Insurance Activity of 2010 contains provisions which normalized the most important issues related to appointing the management system and the internal control system. The effective integrated internal supervision system comprises inter alia: risk control mechanisms, internal control procedures, including procedures for assuring that the institution's operations abide by the laws and internal regulations as well as internal audit. Legislative amendments, however, imposes a set of formal obligations on insurance sector institutions, requiring them to set up an audit committee to assess the institution's internal control and risk management systems, and supervise internal audit activities. In insurance sector institutions with supervisory boards consisting of not more than 5 members, the audit committee's tasks may be entrusted to the supervisory board (Art. 86 of the Act on Statutory Auditors and on the Public Supervision, 2009)¹⁴.

The oversight of activities of institutions insurance sector in individual EU countries is the responsibility of national financial supervision committees - in Poland - Polish Financial Supervision Authority (KNF).

3. The role, purposes and tasks of audit committee in insurance sector institutions

The new integrated internal governance system regime applicable to the insurance sector required under Solvency II is more complex than any previous regulations in force. All institutions insurance sector have an obligation to the introduc-

⁸ *Report of COSO II: Enterprise Risk Management – Integrated Framework*, Committee of Sponsoring Organizations of the Treadway Commission 2004, USA, www.sox-online.com/coso_cobit.html (10.03.2011).

⁹ E.I. Szczepankiewicz, *The role and tasks of the Internal Audit...*, *op.cit.*, p. 28.

¹⁰ *Ustawa z dnia 22 maja 2003 r. o działalności ubezpieczeniowej* (Dz.U. 2013, poz. 950 ze zm).

¹¹ *Ustawa z dnia 21 lipca 2006 r. o nadzorze nad rynkiem finansowym* (Dz.U. Nr 157, poz. 1119 z późn. zm.).

¹² *Ustawa z dnia 7 maja 2009 r. o biegłych rewidentach i ich samorządzie, podmiotach uprawnionych do badania sprawozdań finansowych oraz o nadzorze publicznym* (Dz.U. Nr 77, poz. 649).

¹³ *Rekomendacje dotyczące funkcjonowania komitetu audytu*, Urząd Komisji Nadzoru Finansowego, Warszawa, Listopad 2010.

¹⁴ *Ustawa z dnia 7 maja 2009 r. o biegłych rewidentach...*, *op.cit.*

tion of an effective integrated internal supervision system (Fig. 1), with should comprise the 5 elements (Art. 41-48 of the *Solvency II*).

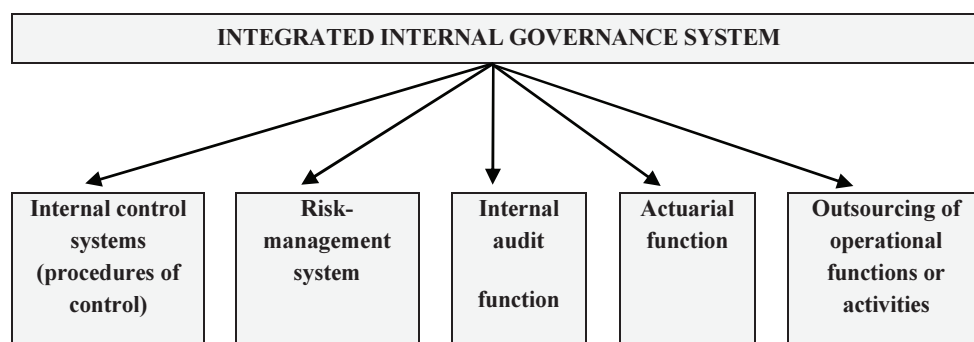


Figure 1. Elements of effective internal governance system in institutions insurance sector

Source: author's own study.

The audit committee supports the supervisory board functioning within a insurance sector institutions, in the execution of control and supervision obligations. Under Art. 86 sections 7-9 Act on Statutory Auditors and on the Public Supervision, an audit committee operating in institutions is obliged to perform the following activities:

- 1) monitoring of the financial reporting process;
- 2) monitoring of the effectiveness of internal control systems, internal audit and risk management;
- 3) monitoring of financial review activities;
- 4) monitoring of independence of the certified external auditor to financial review activities and other activities in institution.

Figure 2 presents internal and external supervision system in insurance institutions according to Polish regulations.

The management board of a insurance sector institutions shall be responsible for the development, introduction and functioning of internal regulations, which determine the activity of audit committee. The main purposes and tasks (Fig. 3) of the audit committee in insurance sector institutions should be described in detail in the rules of operation of the audit committee. In the Author's view, the rules of operation should set out in detail all tasks and the course of action in all areas.

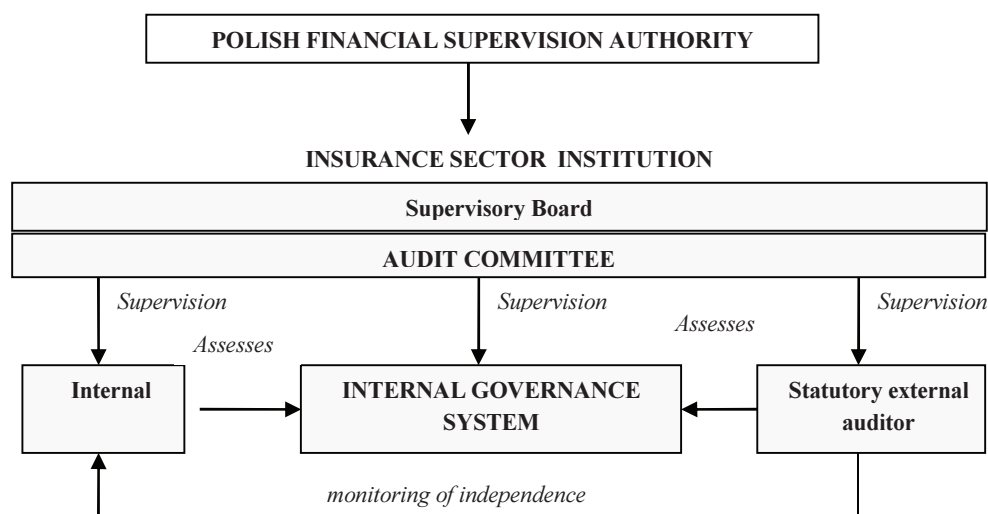


Figure 2. Internal and external supervision system in insurance institutions according to Polish regulations
Source: author's own study.

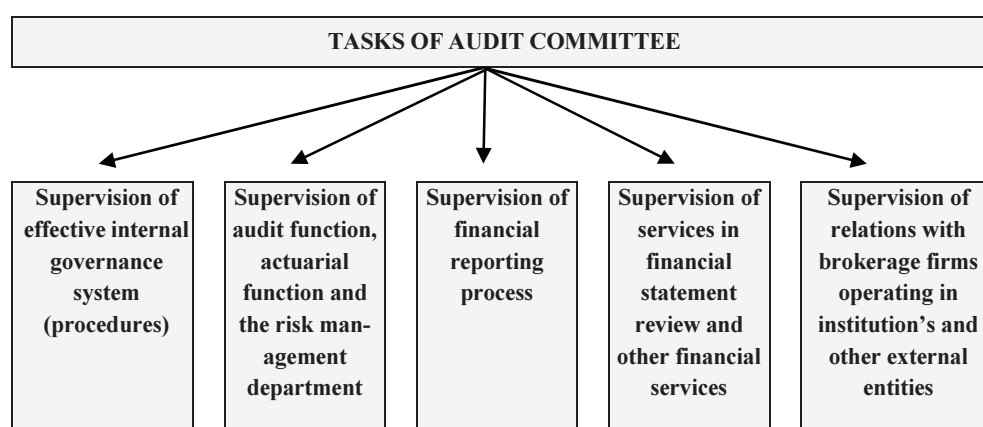


Figure 3. Tasks of audit committee in insurance sector institutions
Source: author's own study.

Table 1 lists sample tasks performed by audit committees in insurance sector institutions.

Table 1. The main areas of activity and exemplary detailed tasks of audit committees in insurance sector institutions

Areas	Exemplary detailed tasks of audit committees
Supervision of the risk- management system (procedures)	<p>The audit committee supervises:</p> <ol style="list-style-type: none"> 1) the adequacy of the risk factors and activity threats identification systems implemented by the management board, 2) it comment on the draft principles of careful and stable management as well as the acceptable levels of risk in the areas of the institution's activity, 3) comments on draft principles of internal capital assessment, capital management and capital planning procedures, 4) comments on draft regulations and amendments to institution regulations on the principles of adherence to standards, including the risk policy, 5) assesses the procedure for exposing irregularities in the institution as implemented by the relevant units.
Supervision of the internal control system (procedures)	<p>The audit committee supervises:</p> <ol style="list-style-type: none"> 1) the effectiveness of internal control systems, the including compliance of institution's operations with the laws in force, the internal procedures, the Articles of Association, and the principles of corporate governance, 2) adherence to procedures and the operation of the internal control systems which reduce the risk of irregularities arising in the institution and implementation of the abuse exposure policy, 3) the assessment of the impact and the manner of implementation of new regulations in internal control system, including KNF's regulations, the standards of auditors.
Supervision of internal audit function, actuarial function and the risk management department	<p>The audit committee supervises:</p> <ol style="list-style-type: none"> 1) the effectiveness of actuarial function and access to sources of information and statutory auditor's opinions and recommendations, 2) the effectiveness of internal audit works and access to sources of information and statutory auditor's opinions and recommendations, 3) the effectiveness of work of the risk management department, the KNF's recommendations and the position of the management board regarding the said recommendations.
Supervision of financial reporting	<ol style="list-style-type: none"> 1) analyzes information about important changes in accounting or financial reporting presented by the management board, and in figures and assessments crucial for financial statements, 2) analyzes annual financial statements and the results of their audit along with the management board and statutory auditors, 3) gives recommendations for the approval of the financial statement audited by a statutory auditor to the supervisory board.
Supervision of services in financial statement review and other financial services	<ol style="list-style-type: none"> 1) recommends a statutory auditor and their change to the supervisory board, assesses his/her performance and independence, taking into consideration the applicable regulations and corporate governance rules, 2) comments on the delivery of services other than financial statements auditing by the statutory auditor, presents the institution's position on this subject, 3) gives recommendations for the amount of remuneration due to the statutory auditor for auditing financial statements or other services provided to the institution and assesses the amount of remuneration paid to the statutory auditor, 4) monitors the independence of the statutory auditor and his/her objectivity in auditing financial statements and interim reports, 5) assesses the effectiveness of the reviews of interim reports and the audits of financial statements, the response of the management board to the statutory auditor's recommendations expressed in the letter to the management board.

Relations with brokerage firms and other external entities (outsourcing)	<ol style="list-style-type: none"> 1) Supervises the effectiveness of outsourcing of critical or important operational functions or activities (e.g. the assessment of the impact: materially impairing the quality of the system of governance of the institution; unduly increasing the operational risk; impairing the ability of the supervisory authorities to monitor the compliance of the institution with its obligations and undermining continuous and satisfactory service to policy holders), 2) gives recommendations regarding the decision approving the conclusion of an important agreement by and between the its brokerage firms operating in institution's and other external entities, 3) monitors the agreements concluded by and between the its brokerage firms operating in institution's and other external entities, including the adequacy of remuneration for the services provided .
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Source: author's own study based on *Rekomendacje dotyczące funkcjonowania komitetu audytu, Urząd Komisji Nadzoru Finansowego*, Warszawa, Listopad 2010, E.I. Szczepankiewicz, *The role and tasks of the Internal Audit...*, op.cit, s. 36-37.

4. The author's concept of integrated audit programme in insurance sector institutions

The audit committee function, as well as the internal control system should be a mainstay of internal control performed in a polish insurance sector institutions in terms of corporate governance. An important element complementing the internal supervision an insurance sector institutions is financial review performed by a certified external auditor.

In the Author's view, the effectiveness of control and supervision exercised by the audit committee in insurance sector institutions can be ensured by the development and implementation of an integrated audit programme. The programme should comprise coordination of activities performed under internal and external audits, including:

- 1) presentation of the principles of operation and structure of the internal governance system (procedures of the internal control and risk-management) to internal and external auditors,
- 2) analysis of auditing results with a view to improving the internal governance system,
- 3) relations between internal and external auditors, joint adoption of auditing methodology and cooperation between internal and external auditors in risk assessment,
- 4) rules applicable to the use of reports issued by certified auditors in previous audits by internal auditors and principles governing external auditors' access to internal audit reports.

Tasks of the audit committee in the context of operation of the integrated audit programme are listed in Fig. 4.

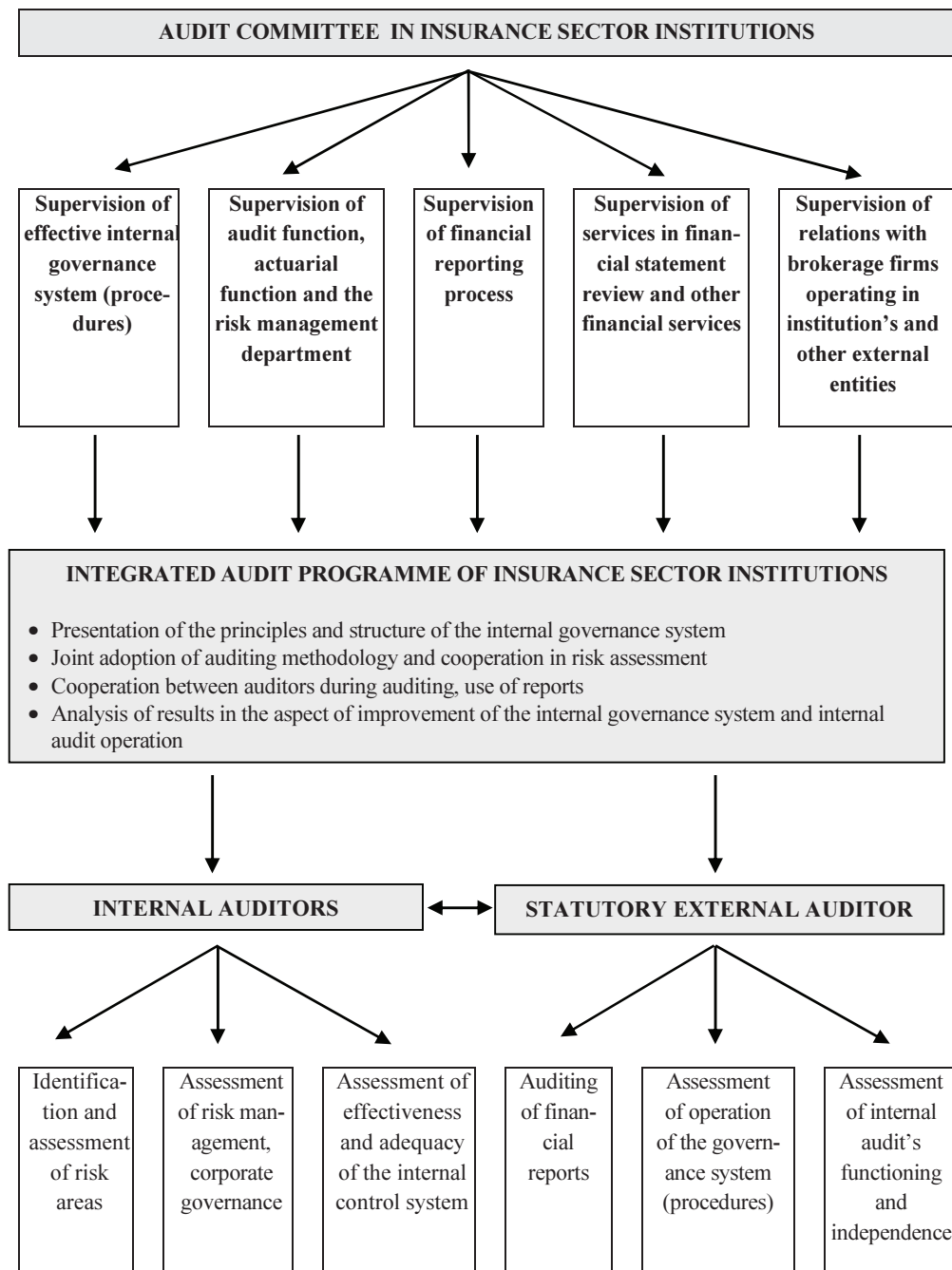


Figure 4. Concept of integrated audit programme
Source: author's own study.

Although the announcement of *Solvency II* for 3 years had passed yet to be established Polish law for insurance sector institutions in internal audit function. In view of the lack of appropriate Polish regulations, the Polish Financial Supervision Authority (KNF) advises insurance sector institutions to follow international standards.

That is why insurance sector institutions in the organization and conduct of the internal audit may apply to International Standards for the Professional Practice of Internal Auditing, published by the Institute of Internal Auditors (IIA). These standards are likely in 2014 will be adopted for use in the Polish insurance sector institutions, similarly as it has in recent years in banks and other institutions.

Under the regulations of the Internal Audit Standards¹⁵ internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an institution's operations. It helps an institution accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. Internal audits should provide unit management with an unbiased and independent evaluation of management and internal control mechanisms, inclusive of financial control procedures, are in place and operate adequately, effectively and efficiently.

An internal audit encompasses examination and evaluation of risk management and task execution quality. Internal audits include assurance activities (evaluation) and consulting services. Assurance services involve the internal auditor's objective assessment of evidence to provide an independent opinion or conclusions regarding an undertaking, an operation, a function, a process, system, or other subject matter¹⁶. An internal audit should cover all areas of institution operations. Audit by counseling should also lead to the facilitation of institution operations. An internal auditor can submit requests to the management or the management of audited institutions, which should result in the facilitation of the operation of a undertaking or its organizational undertakings¹⁷.

Internal audit assesses the effectiveness internal control procedures, risk management procedures and other mechanisms in institution. The aims of internal audit are pursued on the basis of a wide range of courses of action set out in IIA's Standards, such as responsibility of the undertaking's management for the internal control system; auditing approach oriented towards improvement of the undertaking's operations; ensuring high quality of auditing; independence, impartiality and

¹⁵ *The International Standards for the Professional Practice of Internal Audit* (1998, 2001, 2009, 2012), IIA, www.iaa.org (10.03.2013).

¹⁶ *Ibidem*.

¹⁷ E.I. Szczepankiewicz, *The conditions and rules of internal audit in local governments units* [w:] *Zarządzanie finansami w jednostkach samorządu terytorialnego*, red. E. Urbańczyk, Zeszyty Naukowe nr 30 Polskiego Stowarzyszenia Zarządzania Wiedzą, Bydgoszcz 2010, s. 363-364; E.I. Szczepankiewicz, M. Kiedrowska, *Organizacja audytu wewnętrznego w zakładach ubezpieczeń w świetle Solvency II oraz standardów audytu* [w:] *Ubezpieczenia wobec wyzwań XXI wieku*, (red.) W. Ronka Chmielowiec, Prace naukowe UE we Wrocławiu 228, Wrocław 2011, s. 456.

objectivity of auditors in issuing opinions; professional approach, proficiency and due care of the auditor's operations; effective use of internal audit resources; free flow of information and proper communication, and others¹⁸.

5. Final remarks

The audit committee, internal audit and internal control system should be the three main pillars of the internal supervision framework in insurance sector institutions. An important element complementing the internal supervision function in an organization is financial review performed by a certified external auditor, and supervision exercised by national financial supervision committees.

Over the last couple of years, there has been a lot of discussion on the international scene about increasing the effectiveness of risk management and adequacy of internal control systems in insurance sector institutions, and about the role and purpose of the bodies responsible for the corporate governance of these areas. Regulations (Solvency II and other directives, as well as standards) are made to extend the competences and responsibilities of supervisory boards and their committees. The supervisory solutions and regulations for insurance sector institutions, which apply in particular EU countries are similar.

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¹⁸ IIA's Standards No 1000-2600; M. Kiedrowska, E.I. Szczepankiewicz, *Internal control in the concept of integrated Enterprise Risk Management (ERM) system in insurance undertakings* [w:] Zarządzanie finansami – doświadczenia i perspektywy globalizacji, Zeszyty Naukowe Uniwersytetu Szczecińskiego Nr 640 (Finanse, Rynki, Ubezpieczenia Nr 38), Szczecin 2011, s. 704; E.I. Szczepankiewicz, M. Kiedrowska *Organizacja audytu wewnętrznego...*, op.cit., s. 456; E.I. Szczepankiewicz, *The role and tasks of the Internal Audit...*, op.cit., s. 33-34.

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Abstrakt:

Nowa rola komitetu audytu i koncepcja zintegrowanego programu audytu w zakładach ubezpieczeń i zakładach reasekuracji

Komitet audytu i system kontroli wewnętrznej stanowią zasadnicze elementy sprawowanego *corporate governance* w polskim sektorze instytucji ubezpieczeniowych. Istotnym uzupełnieniem funkcji kontroli wewnętrznej w instytucji jest rewizja finansowa, wykonywana przez biegłego rewidenta, jak również zewnętrzny nadzór finansowy. W opracowaniu opisano wpływ nowelizacji przepisów prawnych i innych regulacji na tworzenie wewnętrznego systemu nadzoru w instytucjach sektora ubezpieczeń. Omówiono rolę, funkcje i zadania komitetu audytu jako organu wspomagającego efektywny nadzór wewnętrzny w instytucjach sektora ubezpieczeń. Artykuł prezentuje autorską koncepcję zintegrowanego programu audytu w instytucjach tego sektora. Metodą badawczą przyjętą w opracowaniu jest analiza regulacji z zakresu nadzoru wewnętrznego i wnioskowanie.

The new role of audit committee and concept of integrated audit programme in insurance undertakings and reinsurance undertakings

The audit committee and internal control system should be a mainstay of internal control performed in a polish insurance sector institutions in terms of corporate governance. An important element complementing the internal control function in an organization is financial review performed by a certified external auditor, as well as the external financial supervision. It describes the impact of the amendment of laws and other regulations on the development of the present internal governance and supervision systems in insurance sector institutions. It draws attention to the role and tasks of the audit committee as the bodies supporting effective supervision in insurance sector institutions. The paper presents the author's concept of integrated audit programme in insurance sector institutions.

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