

**BEEMA SAMITI  
(INSURANCE BOARD)**



**INTERNAL AUDIT DIRECTIVE FOR INSURERS**

**2072**





## INTERNAL AUDIT DIRECTIVE FOR INSURERS, 2072

(Adopted by the Board on 2072.05.14)

Insurance Board has issued the following **Internal Audit Directive for Insurers** in exercise of the power conferred by Sub-section (Gha2) of Section-8 of Insurance Act, 2049 for the purpose of facilitating the insurers to comply with requirement of relevant Act, Rules and Regulation and to ensure quality audit.

### Chapter-1 Preliminary

#### 1. Brief Name and Commencement:

- (1) The name of this directive shall be "**Internal Audit Directive for Insurers, 2072**".
- (2) This directive shall commence immediately.

#### 2. Definitions:

'Internal audit' here means an independent management function, which involves a continuous and critical appraisal of the functioning of an insurer with a view to suggest improvement thereto, and add value to and strengthen the overall governance mechanism of the insurer, including the insurer's strategy risk management and internal control system.

All other words and expressions used herein and not defined in this directive but defined in the Insurance Act 2049 or in the Insurance Regulations, 2049 or in any Directives made there under, shall have the same meanings respectively assigned to them in those Acts or Regulations or Directives.

### Chapter-2 Audit Committee

#### 3. Formation of Audit Committee.

- (1) The Board shall constitute an audit committee consisting of at least three members including a director (Independent), who is not involved in day to day operation. The Independent director shall be the chairperson of the audit committee.

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- (2) At least one member of the audit committee shall be a financial expert (Preferably Chartered Accountant) having more than 5 years experience on accounting or auditing or a person having more than 10 years of experience in accounting or auditing or financial field after having obtained at least bachelor's degree in accounts, commerce and finance.
- (3) In case of Insurer not having head office in Nepal, instead of audit committee alternative committee should be headed by an independent experienced person (Preferably Chartered Accountant) having more than 5 years experience on accounting or auditing or financial field or a person having more than 10 years of experience in accounting or auditing or financial field after having obtained at least bachelor's degree in accounts, commerce and finance appointed by their head office under recommendation by CEO of Nepal office.
- (4) Sufficient remuneration should be provided to the independent experienced person heading the alternative committee.
- (5) Chief Executive Officer, Finance head and any person who is a close relative of the chief executive of a company shall not be eligible to be a member of the audit committee.

#### 4. Rights and Duties of Audit committee.

The audit committee shall have the following right and duties.

- (1) To inspect and observe all books of accounts, financial statements and other documents including board minutes of the insurers.
- (2) To take documents and statements of insurers in his /her custody.
- (3) Consider the effectiveness of the company's internal control system, including information technology security and control.
- (4) Understand the scope of internal auditor's review of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with management's responses.
- (5) Recommend for the appointment and removal of the internal auditor. Ensure there is no unjustified restriction or limitation.
- (6) Approve the annual internal audit plan and all major changes to the plan. Review the internal audit activity's performance relative to its plan.
- (7) Review with the internal auditor the internal audit budget, resource plan, activities.

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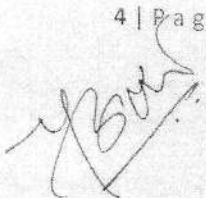


- (8) At least once a year, review the performance of the internal auditor and concur with the annual compensation and remuneration adjustment.
  - (9) Review the effectiveness of the internal audit function, including confirmation with independence and Code of Ethics.
  - (10) On a regular basis, meet separately with the internal auditor to discuss any matters that the committee or internal auditor believes should be discussed privately.
  - (11) Review quarterly internal audit report and forward to the board of directors with recommendations for corrective measures.
  - (12) Audit committee shall be responsible for review of status of its recommendations and action to be taken for non compliance of its recommendation.
5. **Meeting:** The committee will meet at least four times a year, with authority to convene additional meetings, as circumstances require and submit the report to the board of insurers. The gap between the two consecutive meetings should not be more than three months.

### **Chapter-3** **Internal Auditor**

#### **6. Appointment, Removal, Engagement of Internal Auditor:**

- (1) The internal auditor of the insurer shall be appointed by its Board of Directors on recommendation of the Audit Committee.
- (2) The internal auditor should be compulsorily hired from a firm of Chartered Accountancy.
- (3) If the insurer wishes to discontinue with the internal auditor or the internal auditor wishes to discontinue with the insurer during the audit tenure intimation with appropriate reason shall be given to Insurance Board.
- (4) If the internal auditor discontinues his/her office during audit tenure by whatsoever reason under sub directive (3), in that situation the internal auditor should be appointed by the insurer and its intimation should be provided to the Insurance Board within fifteen days.
- (5) During the course of audit if there arises any conflict/constraints between internal auditor and the insurer which results in non-fulfillment of audit assignment both the parties should be equally responsible to inform Insurance Board within seven days.



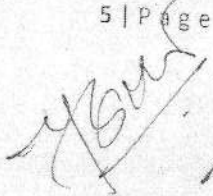


- (6) A full time chartered accountant should be engaged during the audit period.
- (7) All branch audits should be conducted by internal auditor during one fiscal year audit period.
- (8) The audit engagement and audit plan may be reviewed by Insurance board if necessary.

#### **Chapter-4** **Internal Audit Report**

#### **7. Reporting by Internal Auditor and Submission of Internal Audit Report:**

- (1) Internal auditor shall report to the audit committee of the insurer.
- (2) Insurer has to submit internal audit report to the insurance board after inserting management comment on that report and after concluding the said report by audit committee.
- (3) Internal auditor shall also report to Insurance Board immediately any significant audit finding uncovered in the course of audit that would adversely affect the Insurer's operating and financial condition.
- (4) Audit committee and internal auditor will be ultimately responsible for the internal audit report submitted to the insurance board.
- (5) The Insurer has to submit to the Insurance Board Internal Audit Report duly signed by the auditor and audit committee within sixty (60) days from the end of each quarter in every fiscal year.
- (6) In case of the insurer not having its head office in Nepal, the office in Nepal will have to make arrangements for internal audit and has to submit to the Board as per this directive.
- (7) In order to communicate the audit results effectively, the structure of the Internal Audit Report should include the following:
  - a. An executive summary;
  - b. Date of report and period covered by the internal audit;
  - c. The scope and objectives of the internal audit;
  - d. The significance and magnitude of the problems or issues;
  - e. The causes of the problems or issues;
  - f. Recommended solutions or preventive actions;
  - g. Insurer's comments on the issues and recommendations, and remedial measures taken;
  - h. Management's achievements noted during the internal audit;
  - i. Follow-up reports of previous audits; and
  - j. Overall conclusion.





**Chapter-5**  
**Scope of Internal Audit**

**8. Coverage of Internal Audit:**

The scope of internal audit/audit report shall include but will not be limited to:

**(1) Compliance**

- i. Compliance with Laws, Rules and Regulations, Policies and Procedures, Guidelines and Directives.
- ii. The internal auditor must review operational, financial and legal compliance including Insurance Act, 2049, Insurance regulation, 2049, Directives and Circulars issued by Insurance Board and compliance with other prevailing Acts, Rules and Regulations.

**(2) Risk Management System**

The following are some of the audit concerns with respect to the overall risk management system:

- i. Effective management supervision is practiced by the board and its delegated authorities;
- ii. Procedures that identify and quantify the level of risk on a timely basis are in place;
- iii. Limits or other controls are in place to manage the risk;
- iv. Reports to the management accurately present the nature and level of risk taken and any non-compliance with approved policies and limits;
- v. Responsibilities for managing individual risks are clearly identified;
- vi. Procedures to assess the controls over the possibility and impact of various risks.

**(3) Economical, Effective and Efficient Utilization of Resources**

The internal audit should encompass safeguard of assets and economic use of its resources and extend role of compliance audit to cover management auditing and budgetary process. The internal auditors should review whether:

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- i. Established system for planning, appraising, authorizing and controlling the use of resources are operational and effective;
- ii. Operating standards have been established for measuring the economy, efficiency and effectiveness of resources employed have been met;
- iii. Deviations from operating standards are promptly identified, analyzed and communicated to those responsible for taking remedial measures; and
- iv. Remedial or corrective actions have been taken.

(4) **Underwriting:**

- i. Review mechanism used to identify and manage the risks associated with underwriting and underwriting process, including but not limited to timing, investment return, credit, expenses and loss occurrence risks.

ii. **Policies and procedures**

- a) Adequacy of policies and procedures;
- b) Compliance with the insurer's underwriting policies and procedures and adequacy of its internal controls;
- c) Accumulation of risks (general) / multiple policies are checked by underwriters prior to acceptance of risk;
- d) Controls exist over the acceptance and change of risks and the subsequent issuance of policy and endorsement documents;
- e) Controls exist over the collection of premium monies from direct clients and insurance brokers;
- f) Procedures governing the issuance of renewal notices are in place; and
- g) Adequate controls are instituted over the safeguarding and issuance of cover notes for general insurance.





(5) Reinsurance

- i. Policies and procedures for evaluation and fixing of risks retention limits, and the evaluation of the quality reinsurers are set;
- ii. Reinsurance program is reviewed regularly to ensure reinsurance needs are properly and adequately met; and
- iii. Important reinsurance documentations are properly handled.

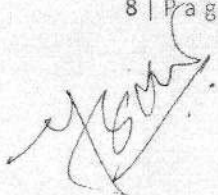
(6) Accounting and financial reporting

- i. Reporting system provides accurate statistical records of the insurer's underwriting data;
- ii. The premium recording system for life business is adequate and reliable;
- iii. Reports to management and the board are relevant, accurate, adequate and timely;
- iv. Premiums, reinsurance premiums ceded, return premiums and commissions expenses are correctly stated and properly accounted for in the insurer's records;
- v. Commissions payable and receivables are accurately and completely accounted for; and
- vi. Adequate provision is made for amounts due which have been outstanding.

(7) Claims

The internal auditors should address, among others, the following areas of audit concern:

- i. Adequacy of policies and procedures;
- ii. Claims process complies with the approved policies and procedures;
- iii. Segregation of duties and responsibilities relating to claims processing/ approval and payment is practiced;
- iv. Register of claims is maintained by the insurer. All claims or known losses should be promptly registered with reasonable provision;
- v. Claims data are accurately recorded to ensure
  - a. Prompt in processing and paying claims and no 'delay tactics';
  - b. Disbursement of claims are properly approved and supported by appropriate documentation; and
  - c. Preventive measures are in place to deter fraud.





- vi. Estimates of preliminary loss reserves are reasonable, regularly reviewed and updated upon receipt of fresh and relevant information;
- vii. Claims settled through compromise or ex-gratia basis are reasonable, justifiable and not subject to abuse;
- viii. All recoveries in respect of salvage, subrogation or from reinsurers are properly recorded and collected on a timely basis;
- ix. Outstanding loss reserves are adequate at any point of time;
- x. Proper monitoring system is in place to record accumulation of claims arising from a particular event or within a particular period; and
- xi. A system is in place to identify maturing life policies to enable payments to be made promptly.
- xii. A system is in place to identify surrenders and lapses.

The internal auditors should pay particular attention to the following in the financial reporting system of insurance claims:

- a. Provides accurate statistical records of the insurer's outstanding claims.
- b. Reports are relevant, accurate, adequate and timely;
- c. Reserves for outstanding loss are adequate and correctly recorded;
- d. Payments of claims are accurately recorded and provision for claims is reduced or eliminated immediately; and
- e. Balances of outstanding claims list agree with the general ledger.

(8) **Management Information System (MIS)**

In reviewing the MIS management function, the internal auditors should pay particular attention to the following:

- i. MIS strategic plan is consistent with the insurer's business objectives and goals;
- ii. Participation from the internal audit department is included if an MIS steering committee is established;
- iii. Standards and procedures on the various MIS activities such as systems development and programming, computer operations and security, teleprocessing and computerized applications including data

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- integrity and Electronic Fund Transfer are adequate and in compliance with the regulated policy;
- iv. The organizational structure of the MIS department provides proper reporting line;
  - v. Management reports on the IS activities are adequate and effective in monitoring MIS performance and in assisting management to make business decisions;
  - vi. MIS staff and users are adequately trained; and
  - vii. MIS activities have complied with relevant guidelines issued by statutory bodies if applicable from time to time.

In reviewing systems development and programming function, the main areas of concern should include availability and comprehensiveness of standards and procedures, compliance of development of application system with standards and documentation and effectiveness of maintenance of application system and programs. In term of computer operations and security, internal audit should include adequacy and effectiveness of computer operation procedures and physical control of computer equipments as well as competency of staff handling security functions and adequacy of procedures on security administration.

Internal auditor should also review the adequacy and compliance of procedures on teleprocessing activities and security system implemented. The areas of concern for data integrity include adequacy and effectiveness in controls over input of data, programmed controls (e.g. edit checks, reasonable checks) and controls over output distribution.

(9) **Procurement**

- i. Procurement system is consistent with the insurer's business objectives and goals;
- ii. Procurement process complies with approved purchase manual and guidelines of the company.
- iii. Procurement of fixed assets is within the limit as prescribed by insurance board from time to time.

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(10) **Human Resource Management**

- i. Adequacy of and compliance with HR policies and Manual;
- ii. Ensure recruitment, promotion and development of HR is in line with insurer HR policy.
- iii. Ensure that the provisions of labour act, bonus act and other relevant acts duly complied.

(11) **Investments**

The internal auditors should focus on the following significant areas:-

- i. Adequacy of and compliance with policies and procedures;
- ii. Investment operations are in line with investment strategy;
- iii. Segregation of duties for trading, processing, custody, payment and receipt, and maintenance of subsidiary records and accounting functions is practiced;
- iv. No over-concentration of investment in a particular counter;
- v. Trading and exposure limits imposed by the board are not breached;
- vi. Reconciliation of the trading transactions against the accounts;
- vii. Regular revaluation exercise is carried out on the investment portfolio;
- viii. Adequate provision for permanent diminution in value has been made for securities of inferior quality; and Securities borrowed or lent out are properly accounted.

**Chapter-6**  
**Miscellaneous**

9. **Separate Disclosure:**

- i. There should be a separate section for corporate government in internal audit report.
- ii. The level of follow up of previous audit report should also be compulsorily included in current audit report

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10. Communication between internal and external auditor:

There should be communication between external and the internal auditor and if needed the internal auditor should exchange information with external auditor.

11. Right to clarify:

If there arises any confusion or disputes during the implementation of this directive the Insurance Board reserve the right to clarify the confusion or disputes.

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