

## INTERNAL AUDIT FUNCTION

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**House Bill 5243 (proposed substitute H-1)**  
**Sponsor: Rep. Brad Paquette**  
**Committee: Insurance**  
**Complete to 12-2-19**

Analysis available at  
<http://www.legislature.mi.gov>

## SUMMARY:

House Bill 5243 would amend Chapter 10 (Annual Audited Financial Reports) of the Insurance Code to require an *internal audit function* (IAF) for certain insurers or groups of insurers. The bill would adopt revisions made by the National Association of Insurance Commissioners (NAIC) to its annual financial reporting model act in August 2014.<sup>1</sup> The adoption of these revisions is an NAIC accreditation requirement effective January 1, 2020.<sup>2</sup>

*Internal audit function* would mean a person or persons that provide independent, objective, and reasonable assurance designed to add value and improve an organization's operations and accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The bill would require an insurer that has annual direct written and unaffiliated assumed premiums of \$500.0 million or more, or a group of insurers with annual direct written and unaffiliated assumed premiums of \$1.0 billion or more, to establish an IAF by January 1, 2021.<sup>3</sup> An insurer that did not meet either threshold on the effective date of the bill, but subsequently did so, would have one year after meeting the threshold to establish an IAF.

An insurer that was a member of an insurance holding company system or included in a group of insurers could satisfy the IAF requirements of the bill at the ultimate controlling parent level, an intermediate holding company level, or the individual legal entity level.

### **IAF Organization and Duties**

The IAF would provide independent, objective, and reasonable assurance to the insurer's audit committee and management regarding the insurer's governance, risk management, and internal controls by performing general and specific audits, reviews, and tests and by employing other techniques considered necessary to protect assets, evaluate control effectiveness and efficiency, and evaluate compliance with policies and regulations.

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<sup>1</sup> See [https://www.naic.org/documents/cmte\\_f\\_rev\\_to\\_annual\\_fin\\_report\\_model\\_reg\\_205\\_mar.pdf](https://www.naic.org/documents/cmte_f_rev_to_annual_fin_report_model_reg_205_mar.pdf)

<sup>2</sup> See [https://www.naic.org/documents/cmte\\_legislative\\_liaison\\_brief\\_accreditation.pdf](https://www.naic.org/documents/cmte_legislative_liaison_brief_accreditation.pdf)

See also <https://content.naic.org/sites/default/files/inline-files/FRSA%20Pamphlet%208-2019.pdf>

<sup>3</sup> These threshold amounts would include international direct and assumed premiums, but exclude premiums reinsured with the Federal Crop Insurance Program and the National Flood Insurance Program.

The IAF would have to be organizationally independent to ensure that internal auditors remain objective, although this requirement would not preclude dual-reporting relationships. The IAF could not defer ultimate judgment on audit matters to others. The IAF would have to appoint an individual as its head, who would have direct and unrestricted access to the board of directors. The head of the IAF would have to report to the audit committee regularly (at least annually) on the periodic audit plan, factors that may adversely impact the IAF's independence or effectiveness, material findings from completed audits, and the appropriateness of corrective actions implemented as a result of audit findings.

The audit committee of an insurer or group of insurers, as defined and regulated in Chapter 10 of the Insurance Code, would be responsible for overseeing the insurer's IAF and granting to it the authority and resources to fulfill its responsibilities.

General and specific audits performed under the bill would not be considered an insurance compliance self-evaluative audit under section 221 of the Insurance Code. [Section 221 defines "insurance compliance audit" as a voluntary, internal evaluation or assessment conducted by or on behalf of an insurer to identify actual or potential noncompliance with applicable laws, regulations, orders, or industry or professional standards.] Documents resulting from or connected with an audit performed under the bill would have to be disclosed to the director of the Department of Insurance and Financial Services (DIFS) upon written request. Documents submitted to DIFS under the bill would be confidential, not subject to subpoena, and not subject to disclosure under the Freedom of Information Act (FOIA) and could not be divulged to any person. The director of DIFS would have to withhold information and documents submitted to DIFS under the bill from public inspection and could not use the information and documents as the sole basis for an examination under section 222 of the Insurance Code.

MCL 500.1001 and 500.1027 and proposed MCL 500.1028

#### **FISCAL IMPACT:**

House Bill 5243 would not have an appreciable fiscal impact on any unit of state or local government.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.