

Comments Template on EIOPA-CP-11/006 Response to Call for Advice on the review of Directive 2003/41/EC: second consultation		Deadline 02.01.2012 18:00 CET
Company name:	DIIR – Deutsches Institut fuer Interne Revision e. V. Ohmstrasse 59, 60486 Frankfurt/Main, Germany	
Disclosure of comments:	EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential. <i>Please indicate if your comments on this CP should be treated as confidential, by deleting the word Public in the column to the left and by inserting the word Confidential.</i>	Public
<p>The question numbers below correspond to Consultation Paper No. 06 (EIOPA-CP-11/006).</p> <p>Please follow the instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ <u>Do not change the numbering</u> in column “Question”. ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a question, keep the row <u>empty</u>. ⇒ There are 96 questions for respondents. Please restrict responses in the row “General comment” only to material which is not covered by these 96 questions. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific question numbers below. <ul style="list-style-type: none"> ○ If your comment refers to multiple questions, please insert your comment at the first relevant question and mention in your comment to which other questions this also applies. ○ If your comment refers to parts of a question, please indicate this in the comment itself. <p>Please send the completed template to CP-006@eiopa.europa.eu, in MSWord Format, (our IT tool does not allow processing of any other formats).</p>		
Question	Comment	
General comment	DIIR – Deutsches Institut fuer Interne Revision e. V., located in Frankfurt am Main, Germany would like to thank EIOPA for the opportunity to comment on the Call for Advice on the review of Directive 2003/41/EC, second consultation.	

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	<p>DIIR is the national association of German Internal Auditors. It represents approximately 2.500 members, including more than 600 corporate members. Amongst the corporate members DIIR is for example currently representing 29 out of 30 DAX-30. Additionally we have numerous large groups and at the same time medium and small enterprises from all different industries as well as public sector entities within our membership base.</p> <p>As such, DIIR is an associated organization of the global Institute of Internal Auditors (the IIA), a professional organization of more than 170,000 members in some 165 countries. Throughout the world, the global IIA is recognized as the Internal Audit profession's leader in certification, education and research regarding Internal Audit. The global IIA also maintains the International Professional Practices Framework (IPPF), which includes the International Standards for the Professional Practice of Internal Auditing (available in 29 languages), the Definition of Internal Audit, the Code of Ethics, Practice Advisories and other guidance (http://www.theiia.org/guidance/standards-and-guidance/interactive-ippf/).</p>	
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63.	DIIR welcomes that EIOPA wants to apply the same material elements of the Solvency II requirements for governance to IORPs. An effective system of governance is key for every undertaking. The components of an effective system of governance are thoroughly described in the	

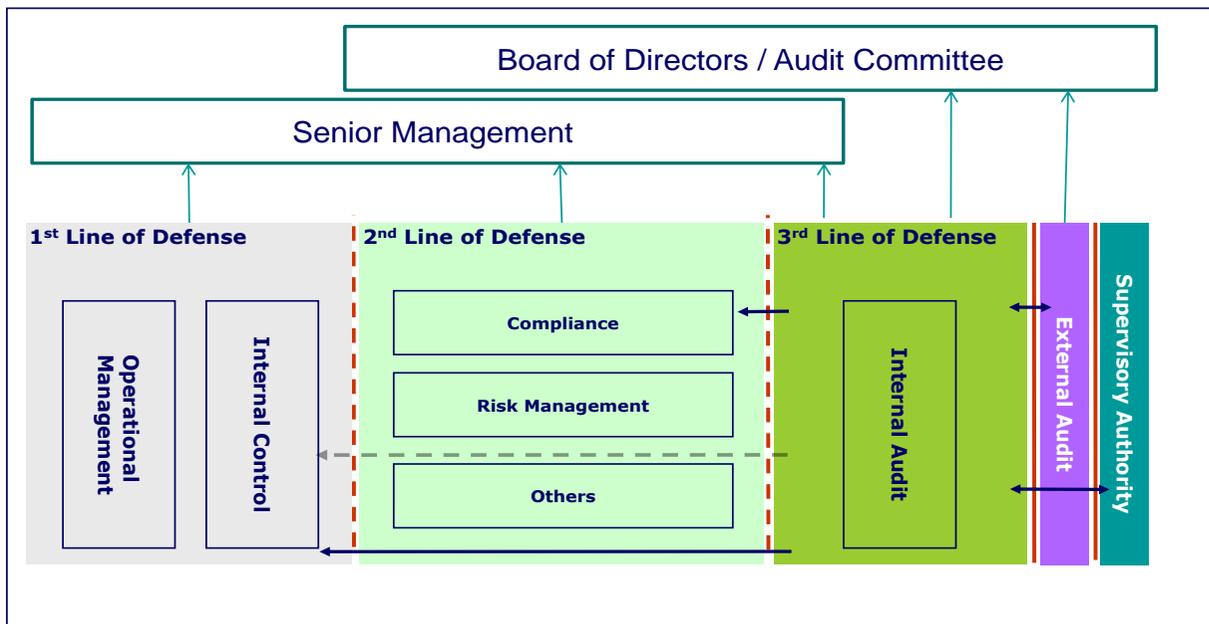
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	Solvency II framework for insurance and reinsurance undertakings. They should also count for IORPs as IORPs face similar risks as insurance undertakings. Less complex and small IORPs will benefit of the principle of proportionality, which allows them to implement a system of governance adapted to their respective business models.	
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74.	<p>DIIR strongly believes that the material requirements of Internal Audit in respect of insurers should also apply to IORPs. Internal Audit is key to an effective system of governance. We would like to elaborate a bit more on this point.</p> <p>Internal Audit represents the so called "Third Line of Defense" for any entity. The "Three lines of Defence-Model" is considered a valid conceptual delineation of control levels :</p> <ul style="list-style-type: none"> • First line: line controls, controls operated by operational management • Second line: in an insurance or reinsurance undertaking consists of activities covered by several components (compliance, risk management, actuarial function), which a.o. facilitate risk management practices by operational management. • Third line: an independent internal audit function providing assurance on internal control and 	

risk management systems.

Three Lines of Defense Model



As stated, in this context Internal Audit represents the so called "Third Line of Defense" for any entity. It is a highly structured profession working under rigorous international professional standards

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(issued by the Institute of Internal Auditors, global body of the profession) with quality assurance rules that include an external assessment at least every five years. On the basis of its role, and if properly structured, it provides a global assurance to the management, administrative or supervisory board on the reliability of the enterprise’s risk management and internal control systems. In this context, assurance is independent evaluation provided to interested parties (stakeholders) to ensure proper decision making and to assist in executing responsibilities over supervising, monitoring or overseeing corporate governance.

The following three points illustrate why the presence of Internal Audit should be considered a mandatory component of the corporate governance structure of an entity.

The Internal Audit function performs a wide scope of examination of processes which provide assurance to the management, administrative or supervisory board of the reliability of internal communication and information. This information is typically pervasive and formulates the basis for strategic and operational decisions of management at all levels up to the Board. Assurance can include:

- Budgetary management reporting
- Risk reporting
- Operational performance reporting
- Accounting processes and interrelationships with operations
- IT processes which, in complex environments, must ensure proper integration of diverse databases and systems.

The second line of controls in an insurance or reinsurance undertaking consists of activities covered by several components of internal governance (compliance, risk management, actuarial function) while the third line independent assurance must be guaranteed by an independent Internal Audit function covering all components of the governance. Efficient and effective interaction between these components is also essential for a truly effective internal control system, as it impacts significantly the overall control environment as well as the essential element of proper and efficient communication and information flowing through the organization.



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Means for providing "assurance" ("third line of defense") over the internal control and risk management systems is based on the activity of independent functions that are capable of identifying misalignments between the design and effective functioning of the internal control system with respect to the enterprise risk management objectives. Internal Audit, by its independence, nature and mission, is an activity intended to provide assurance over the overall adequacy of the internal governance system. The independence of Internal Audit is also a cornerstone to guarantee credibility and avoid potential conflicts of interest and inefficiencies between line and second line control functions.

While the added value derived from Internal Audit may not be entirely quantifiable, the activity of Internal Audit results in systematic improvements to the internal governance (risk management and internal controls) of the organization which can be measured for example through:

- Number and significance of audit recommendations
- Percentage of audit recommendations implemented within an acceptable time frame
- Significance of risks mitigated through the implementation of audit recommendations.

The positive value of Internal Audit depends of course on its own quality structure and performance. Criteria applicable to this includes:

- The effective independence of the Internal Audit function
- The clarity of the mandate of Internal Audit approved by the Board
- The management of the Internal Audit function in accordance with IIA Standards
- The implementation and results of the quality assurance review process required by the International Standards (IPPF), including the external assessment at least every five years by qualified assessors. The competency of the chief audit executive ("fit and proper"), requiring strong leadership capability in addition to technical and communication skills
- The adequacy of resources, both human and technical, including for example appropriate certifications by members of the Internal Audit department as issued by the Institute of Internal Auditors (such as CIA-Certified Internal Auditor, CIIA-Certified International Investment Analyst, CFSA-Certified Financial Services Auditor, CGAP-Certified Government Auditing Professional, CCSA-Certification in Control Self Assessment and CRMA-Certification in Risk Management Assurance).

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Therefore, we very much appreciate the requests on independence and objectivity of Internal Audit as stated in the Call for Advice. They are fully in line with the requests defined by the IPPF. We would like to recommend embedding three more core principles of the work of Internal Audit.

The work of Internal Audit has to be risk-oriented. This means especially the development of a risk-oriented audit plan on a yearly basis ensuring that the high risk areas of the undertaking are covered in an appropriate way. An audit report has to be delivered after each assignment with findings and recommendations delivered to the relevant management, administrative or supervisory body. The adequate documentation and communication of all audit results to stakeholders is key for the effectiveness of Internal Audit. By addressing weaknesses in the internal control system or the risk management system and developing recommendations how to improve the systems Internal Audit adds significant value to an organization. The establishment of a follow-up process to monitor and ensure that management actions have been effectively implemented should also be considered as a minimum requirement towards the Internal Audit function. Without a stringent follow-up process it can not be ensured that actions to improve the internal control or risk management system are implemented and the overall control environment including the system of governance effectively improves.

The IPPF cover these aspects and define other standards, which an Internal Audit function has to fulfill. The IPPF is funded on good practices of Internal Audit functions worldwide and can be seen as the standard followed by the global Internal Audit community. We recommend to have a link to the IPPF in the foreseen directive or any additional guidance. With this link all requirements towards an efficient and effective Internal Audit function could be covered without giving too much detail in the directive or guidance itself.

In conclusion, the Three Lines of Defense model is a truly powerful model that, if correctly applied, will certainly improve the governance of entities. In such a model, Internal Audit assumes the third level of global assurance. Internal Audit thus will provide added value, if properly structured, and should be considered essential for all entities. The management, administrative or supervisory board can rely on this independent function as a significant tool to its oversight over internal control and risk management, integrating it with further information and analyses obtained from risk committees, the statutory auditor, primary "second level" control functions, the entity-level control culture and the organization. Finally, the work of the statutory auditor is facilitated both by the model and by

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	efficient dialogue with the Internal Auditor, promoted by the model itself. The needed integration of assurance over financial and internal reporting is also ensured.	
75.	<p>Regarding the proposed whistle-blowing obligation DIIR do not think such an obligation would be beneficial for Internal Audit and its effectiveness in the system of governance. Internal Audit is solely an internal function. It is responsible only towards the management, administrative or supervisory board and supports this function by overlooking the activities of the entity, especially the risk management, internal control system and the system of governance. Its independence and objectivity towards other functions is key for its success. But a good relationship towards the respective board is also key for the success of Internal Audit. It has to be founded on mutual trust and reliability. This is the precondition for open communication between the relevant body and Internal Audit. Without open communication Internal Audit will have difficulties to obtain the information needed to evaluate the risk situation of the undertaking in an appropriate way.</p> <p>Furthermore notwithstanding its independence in the organization Internal Audit is a function of the undertaking. Internal Auditors are employed by the undertaking and they are responsible towards it. Thus they are not entitled to act against the interests of the undertaking. If they act against the interests of the undertaking, this can lead to severe personal consequences for the employee.</p> <p>The results of Internal Audit should be fully transparent towards the supervisory authority and it should be entitled to receive all Internal Audit reports. But this should happen via an official reporting line including the management, administrative or supervisory board.</p>	
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