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| Regulatory Analysis Form | | This space for use by IRRC | |
| (1) Agency Insurance Department | | RECEIVED 2001 FEB 22 11:11:31 REGULATORY REVIEW COMMISSION IRRC Number: #2150 | |
| (2) I.D. Number (Governor's Office Use) | | | |
| (3) Short Title Miscellaneous Provisions | | | |
| (4) PA Code Cite 31 Pa. Code, Chapter 147 | | (5) Agency Contacts & Telephone Numbers Primary Contact: Peter J. Salvatore, Regulatory Coordinator, 1326 Strawberry Square, Harrisburg, PA 17120, (717) 787-4429 Secondary Contact: Elaine Leitzel, (717) 787-8840 | |
| (6) Type of Rulemaking (check one) <input type="checkbox"/> Proposed Rulemaking <input checked="" type="checkbox"/> Final Order Adopting Regulation <input type="checkbox"/> Final Order, Proposed Rulemaking Omitted | | (7) Is a 120-Day Emergency Certification Attached? <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes: By the Attorney General <input type="checkbox"/> Yes: By the Governor | |
| (8) Briefly explain the regulation in clear and nontechnical language. The purpose of this rulemaking is to update Chapter 147, commonly referred to as the CPA Audit Rule, to reflect current statutory accounting practices and procedures adopted by the National Association of Insurance Commissioners (NAIC). The regulations prescribe requirements for annual audits of financial statements filed by insurers with the Department. The regulations were adopted in 1979 and last amended November 11, 1995. The regulations are based on a model regulation adopted by the NAIC and are included in the NAIC's state accreditation standards for regulation of the financial solvency of the insurance industry. Pennsylvania is currently accredited by the NAIC for compliance with the financial regulation standards. In 1998 the NAIC revised the model regulation to make it consistent with the NAIC's codified <i>Accounting Practices and Procedures Manual</i> (manual) effective January 1, 2001. Insurers subject to these regulations have been advised by Insurance Department Notice Nos. 1998-04 and 2000-02 that they will be required to adhere to the manual in preparing financial statements to be filed with the Department. This rulemaking will update the regulations to be consistent with the manual and the 1998 revisions to the NAIC model regulation. | | | |
| (9) State the statutory authority for the regulation and any relevant state or federal court decisions. The regulations are being amended under the authority of sections 206, 506, 1501 and 1502 of The Administrative Code of 1929 (71 P.S. §§ 66, 186, 411 and 412) relating to the general rulemaking authority of the Department; section 320 of The Insurance Company Law of 1921 relating to the authority of the Commissioner to require insurers to file statements concerning their affairs and financial condition; and section 1605(a)(3)(ii) of The Insurance Company Law of 1921 (40 P.S. §1605(a)(3)(ii)); sections 205 and 206 of The Pennsylvania Fair Plan Act (40 P.S. §§ 1600.205 and 1600.206); 40 Pa.C.S. §§ 6125, 6331 and 6701; sections 11 and 14 of the Health Maintenance Organization Act (40 P.S. §§ 1561 and 1564); section 630 of the act of May 17, 1921 (P.L. 682, No. 284) (40 P.S. § 764a); sections 7 and 25 of the Continuing Care Provider Registration and Disclosure Act (40 P.S. §§ 3207 and 3225); and section 602 of the Fraternal Benefit Societies Code (40 P.S. § 1142.602) which, respectively, relate to the specific regulatory and rulemaking authority of the Department regarding financial reporting by surplus lines insurers, the Pennsylvania Fair Plan, hospital plan corporations, health services plan corporations, health maintenance organizations, preferred provider organizations; continuing care providers and fraternal benefit societies. | | | |

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(10) Is the regulation mandated by any federal or state law or court order, or federal regulation? If yes, cite the specific law, case or regulation, and any deadlines for action. No.

(11) Explain the compelling public interest that justifies the regulation. What is the problem it addresses?

This rulemaking amends § 147.4 (relating to contents of annual audited financial report) to address technical issues involving disclosures required in audit reports to be filed under the requirements of the manual. Section 147.4(2) currently requires the notes to financial statements in annual audited financial reports to include notes required by generally accepted accounting principles (GAAP). Because the Statements of Statutory Accounting Principles (SSAPs) contained in the manual now address all types of required disclosures, the reference to GAAP is no longer needed and has been replaced with a reference to the manual. Section 147.4(2)(i) has been further amended to clarify that the notes shall include a reconciliation of any differences between the audited financial statement and the annual financial statement that the insurer has filed with the Department. Finally, § 147.4(2)(ii) has been deleted because a summary of the ownership and relationships of the insurer and all affiliated companies is required under SSAP No. 1 (relating to disclosure of accounting policies, risks and uncertainties, and other disclosures) in the manual. These amendments will eliminate potentially confusing inconsistencies between the regulations and the manual.

(12) State the public health, safety, environmental or general welfare risks associated with nonregulation.

There are no public health, safety, environmental or general welfare risks associated with the updates to the regulations.

(13) Describe who will benefit from the regulation. (Quantify the benefits as completely as possible and approximate the number of people who will benefit.)

Affected insurers will benefit by the elimination of inconsistencies between the Department's regulations, the manual and the NAIC model, thereby reducing time spent by insurers to resolve the inconsistencies.

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(14) Describe who will be adversely affected by the regulation. (Quantify the adverse effects as completely as possible and approximate the number of people who will be adversely affected.)

No persons, groups or entities will be adversely affected by the updates to the regulations.

(15) List the persons, groups or entities that will be required to comply with the regulation. (Approximate the number of people who will be required to comply.)

All types of insurance companies and continuing care providers licensed to transact business in this Commonwealth and the independent certified public accountants retained by the insurers to conduct annual audits will be required to comply with the updated regulations.

(16) Describe the communications with and input from the public in the development and drafting of the regulation. List the persons and/or groups who were involved, if applicable.

The Department received comments from a group of "Insurance Trade Associations in Support of NAIC Codification" encouraging the Department to adopt the 1998 technical changes to the NAIC model regulation. The group includes the Alliance of American Insurers, American Association of Health Plans, American Council of Life Insurance, American Insurance Association, Blue Cross/Blue Shield Association, Health Insurance Association of America, National Association of Independent Insurers, National Association of Mutual Insurance Companies and Reinsurance Association of America. The Department requested comments from The Insurance Federation of Pennsylvania, Inc., the Pennsylvania Association of Mutual Insurance Companies and counsel for the Pennsylvania Fraternal Congress. In addition, the regulatory process provided for a 30-day public comment period subsequent to publication of the proposed rulemaking in the *Pennsylvania Bulletin*.

(17) Provide a specific estimate of the costs and/or savings to the regulated community associated with compliance, including any legal, accounting or consulting procedures which may be required.

The updates to the regulations would impose no additional costs on affected insurers.

Regulatory Analysis Form

(18) Provide a specific estimate of the costs and/or savings to local governments associated with compliance, including any legal, accounting or consulting procedures which may be required.

There is no fiscal impact on local governments associated with the updates to the regulations.

(19) Provide a specific estimate of the costs and/or savings to state government associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required.

There is no fiscal impact to state government associated with the updates to the regulations.

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(20) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years. N/A

| | Current FY Year | FY +1 Year | FY +2 Year | FY +3 Year | FY +4 Year | FY +5 Year |
|-----------------------------|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| SAVINGS: | \$ | \$ | \$ | \$ | \$ | \$ |
| Regulated Community | | | | | | |
| Local Government | | | | | | |
| State Government | | | | | | |
| Total Savings | | | | | | |
| COSTS: | | | | | | |
| Regulated Community | | | | | | |
| Local Government | | | | | | |
| State Government | | | | | | |
| Total Costs | | | | | | |
| REVENUE LOSSES: | | | | | | |
| Regulated Community | | | | | | |
| Local Government | | | | | | |
| State Government | | | | | | |
| Total Revenue Losses | | | | | | |

(20a) Explain how the cost estimates listed above were derived.

N/A

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(20b) Provide the past three year expenditure history for programs affected by the regulation.

N/A

| Program | FY -3 | FY -2 | FY -1 | Current FY |
|---------|-------|-------|-------|------------|
| | | | | |
| | | | | |
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(21) Using the cost-benefit information provided above, explain how the benefits of the regulation outweigh the adverse effects and costs.

N/A

(22) Describe the nonregulatory alternatives considered and the costs associated with those alternatives. Provide the reasons for their dismissal.

The regulations are based on a model regulation adopted by the NAIC and are included in the NAIC's state accreditation standards for regulation of the financial solvency of the insurance industry. Pennsylvania is currently accredited by the NAIC for compliance with the financial regulation standards. This rulemaking is the most efficient, effective way to prescribe requirements for annual audits consistent with NAIC requirements.

(23) Describe alternative regulatory schemes considered and the costs associated with those schemes. Provide the reasons for their dismissal.

The rulemaking updates existing regulations.

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(24) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulation.

No federal standards are applicable to the updates to the regulations.

(25) How does this regulation compare with those of other states? Will the regulation put Pennsylvania at a competitive disadvantage with other states?

The updates to the regulations will make the regulations consistent with national codified accounting principles for insurance companies prescribed by the NAIC. Pennsylvania is one of 47 states currently accredited by the NAIC for compliance with minimum standards for effective financial solvency regulation. Because the updates to the regulations will make Pennsylvania requirements consistent with NAIC requirements and the requirements in most other states, the regulations will not put Pennsylvania at a competitive disadvantage with other states.

(26) Will the regulation affect existing or proposed regulations of the promulgating agency or other state agencies? If yes, explain and provide specific citations.

No.

(27) Will any public hearings or informational meetings be scheduled? Please provide the dates, times, and locations, if available.

No public hearings or informational meetings have been scheduled on the updates to the regulations.

Regulatory Analysis Form

(28) Will the regulation change existing reporting, record keeping, or other paperwork requirements? Describe the changes and attach copies of forms or reports which will be required as a result of implementation, if available.

No.

(29) Please list any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, elderly, small businesses, and farmers.

None.

(30) What is the anticipated effective date of the regulation; the date by which compliance with the regulation will be required; and the date by which any required permits, licenses or other approvals must be obtained?

The updates to the regulations will take effect after approval by the legislative standing committees, the Independent Regulatory Review Commission and the Office of the Attorney General; and upon final publication in the *Pennsylvania Bulletin*.

(31) Provide the schedule for continual review of the regulation.

The Department reviews regulations on a triennial basis.

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| CDL-1 FACE SHEET FOR FILING DOCUMENTS WITH THE LEGISLATIVE REFERENCE BUREAU (Pursuant to Commonwealth Documents Law) | | RECEIVED 2001 FEB 22 10:18 AM REVIEW COMMISSION |
| # 2150 | | DO NOT WRITE IN THIS SPACE |
| Copy below is hereby approved as to form and legality. Attorney General By _____ (Deputy Attorney General) _____ Date of Approval Q Check if applicable. Copy not approved. Objections attached. | Copy below is hereby certified to be a true and correct copy of a document issued, prescribed or promulgated by: Insurance Department _____ (AGENCY) DOCUMENT/FISCAL NOTE NO. <u>11-203</u> DATE OF ADOPTION: _____ BY: <u>M. Diane Koken</u> M. Diane Koken TITLE: <u>Insurance Commissioner</u> | Copy below is hereby approved as to form and legality. Executive or Independent Agencies <u>John V. Turner</u> _____ <u>2/12/01</u> DATE OF APPROVAL (DEPUTY GENERAL COUNSEL) (CHIEF COUNSEL, INDEPENDENT AGENCY) (STRIKE INAPPLICABLE TITLE) Q Check if applicable. No Attorney General approval or objection within 30 days after submission. |

NOTICE OF FINAL-FORM RULEMAKING

INSURANCE DEPARTMENT

31 Pa. Code, Chapter 147, §§147.1-147.15

ANNUAL AUDITED INSURERS' FINANCIAL REPORT REQUIRED

PREAMBLE

The Insurance Department (Department) by this order amends Chapter 147 (relating to annual audited insurers' financial report required) to read as set forth in Annex A. The regulations require insurers to have annual audits of their year-end financial statements conducted by independent certified public accountants.

Purpose

The purpose of this rulemaking is to update Chapter 147, commonly referred to as the CPA Audit Rule, to reflect current statutory accounting practices and procedures adopted by the National Association of Insurance Commissioners (NAIC). The regulations prescribe requirements for annual audits of financial statements filed by insurers with the Department. The regulations were adopted in 1979 and last amended November 11, 1995. The regulations are based on a model regulation adopted by the NAIC and are included in the NAIC's state accreditation standards for regulation of the financial solvency of the insurance industry. The Commonwealth is currently accredited by the NAIC for compliance with the financial regulation standards. In 1998 the NAIC revised the model regulation to make it consistent with the NAIC's codified *Accounting Practices and Procedures Manual* (manual) effective January 1, 2001. Insurers subject to these regulations have been advised by Insurance Department Notice Nos. 1998-04 and 2000-02 that they will be required to adhere to the manual in preparing financial statements to be filed with the Department. This rulemaking will update the regulations to be consistent with the manual and the 1998 revisions to the NAIC model regulation.

This rulemaking amends § 147.4 (relating to contents of annual audited financial report) to address technical issues involving disclosures required in audit reports to be filed under the requirements of the manual.

Section 147.4(2) currently requires the notes to financial statements in annual audited financial reports to include notes required by generally accepted accounting principles (GAAP). Because the Statements of Statutory Accounting Principles (SSAPs) contained in the manual now address all types of required disclosures, the reference to GAAP is no longer needed and has been replaced with a reference to the manual. Section 147.4(2)(i) has been further amended to clarify that the notes shall include a reconciliation of any differences between the audited financial statement and the annual financial statement that the insurer has filed with the Department. Finally, § 147.4(2)(ii) has been deleted because a summary of the ownership and relationships of the insurer and all affiliated companies is required under SSAP No. 1 (relating to disclosure of accounting policies, risks and uncertainties, and other disclosures) in the manual. These amendments will eliminate potentially confusing inconsistencies between the regulations and the manual.

Statutory Authority

This final-form rulemaking is adopted under the authority of sections 206, 506, 1501 and 1502 of The Administrative Code of 1929 (71 P.S. §§ 66, 186, 411 and 412) relating to the general rulemaking authority of the Department; section 320 of The Insurance Company Law of 1921 relating to the authority of the Commissioner to require insurers to file statements concerning their affairs and financial condition; and section 1605(a)(3)(ii) of The Insurance Company Law of 1921 (40 P.S. §1605(a)(3)(ii)); sections 205 and 206 of The Pennsylvania Fair Plan Act (40 P.S. §§ 1600.205 and 1600.206); 40 Pa.C.S. §§ 6125, 6331 and 6701; sections 11 and 14 of the Health Maintenance Organization Act (40 P.S. §§ 1561 and 1564); section 630 of the act of May 17, 1921 (P.L. 682, No. 284) (40 P.S. § 764a); sections 7 and 25 of the Continuing Care Provider Registration and Disclosure Act (40 P.S. §§ 3207 and 3225); and section 602 of the Fraternal Benefit Societies Code (40 P.S. § 1142.602) which, respectively, relate to the specific regulatory and rulemaking authority of the Department regarding financial reporting by surplus lines insurers, the Pennsylvania Fair Plan, hospital plan corporations, health services plan corporations, health maintenance organizations, preferred provider organizations; continuing care providers and fraternal benefit societies.

Comments

Notice of the proposed rulemaking was published at 30 Pa.B. 5023 (September 30, 2000) with a 30-day public comment period.

No comments were received from the standing committees. The Insurance Federation of Pennsylvania, Inc., commented in support of the proposed rulemaking. The Independent Regulatory Review Commission (IRRC) submitted its comments and recommendations to the Department on November 30, 2000.

IRRC recommended that the phrase “and other applicable laws and regulations” in § 147.4(b)(2) be deleted or clarified. Subsection 147.4(b)(2) requires an annual audited financial report to include a reconciliation of differences, if any, between the audited statutory financial statements and the annual statements already on file with the Department. A reference to the specific laws and regulations that require the filing of annual statements with the Department is not needed to understand the meaning and intent of § 147.4(b)(2). Therefore, the Department has responded to IRRC’s comment by deleting the phrase “under section 320 of The Insurance Company Law of 1921 (40 P.S. § 443) and other applicable laws and regulations” in this final-form rulemaking.

Fiscal Impact

The final-form rulemaking has no fiscal impact on state government, the general public, political subdivisions or the private sector.

Paperwork

The final-form rulemaking would impose no additional paperwork requirements on the Department or affected insurers.

Persons Regulated

The final-form rulemaking applies to insurance companies, other insurer entities and continuing care providers licensed to transact business in this Commonwealth and the independent certified public accountants retained by those insurers to conduct annual audits.

Contact Person

Questions or comments regarding this final-form rulemaking may be addressed in writing to Peter J. Salvatore, Regulatory Coordinator, Pennsylvania Insurance Department, Office of Special Projects, 1326 Strawberry Square, Harrisburg, Pennsylvania 17120, telephone: (717) 787-4429. Questions and comments may also be e-mailed to psalvatore@state.pa.us or faxed to (717) 705-3873.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P.S. §745.5(a)), the agency submitted a copy of this regulation on September 21, 2000, to the Independent Regulatory Review Commission (IRRC) and to the Chairpersons of the Senate Committee on Banking and Insurance and the House Committee on Insurance. In addition to the submitted regulation, the agency has provided IRRC and the Committees with a copy of a detailed Regulatory Analysis Form prepared by the agency in compliance with Executive Order 1996-1, "Regulatory Review and Promulgation." In compliance with section 5(c) of the Regulatory Review Act (71 P.S. § 745.5(c)), the agency also provided IRRC and the Committees with copies of the comments received. A copy of that material is available to the public upon request.

This final-form regulation was deemed approved by the Senate Committee on Banking and Insurance on _____ and deemed approved by the House Committee on Insurance on _____ in accordance with section 5a(d) of the Regulatory Review Act (71 P.S. § 745.5a(d)). The IRRC met on _____ and approved the regulation in accordance with section 5a(e) of the Regulatory Review Act (71 P.S. §745.5a(e)).

Findings

The Insurance Commissioner finds that:

(1) Public notice of intention to adopt this rulemaking as amended by this order has been given under sections 201 and 202 of the act of July 31, 1968 (P.L. 769, No. 240) (45 P.S. §§ 1201 and 1202), and the regulations thereunder, 1 Pa. Code §§ 7.1 and 7.2.

(2) The adoption of this rulemaking in the manner provided in this order is necessary and appropriate for the administration and enforcement of the authorizing statutes.

Order

The Insurance Commissioner, acting under the authorizing statutes, orders that:

(1) The regulations of the Department, 31 Pa. Code, Chapter 147, are amended to read as set forth in Annex A.

(2) The Commissioner shall submit this order and Annex A to the Office of General Counsel and Office of Attorney General for approval as to form and legality as required by law

(3) The Commissioner shall certify this order and Annex A and deposit them with the Legislative Reference Bureau as required by law.

(4) This order shall take effect upon publication in the *Pennsylvania Bulletin*.

M. DIANE KOKEN
Insurance Commissioner

CONTINUATION SHEET FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU
Pursuant to Commonwealth Documents Law

Annex A

**TITLE 31. INSURANCE. PART VIII.—MISCELLANEOUS PROVISIONS.
CHAPTER 147 -- ANNUAL AUDITED INSURERS' FINANCIAL REPORT
REQUIRED**

Sec.

- 147.1. Purpose.
- 147.2. Definitions.
- 147.3. Filing and extensions for filing of annual audited financial report.
- 147.4. Contents of annual audited financial report.
- 147.5. Designation of independent certified public accountant.
- 147.6. Qualifications of independent certified public accountant.
- 147.7. Consolidated or combined audits.
- 147.8. Scope of audit and report of independent certified public accountant.
- 147.9. Notification of adverse financial condition.
- 147.10. Report on significant deficiencies in internal controls.
- 147.11. Definitions, availability and maintenance of independent certified public accountant workpapers.
- 147.12. Examinations.
- 147.13. Effective date and exemption.
- 147.14. Penalties.
- 147.15. Letter of qualifications of independent certified public accountant.

§ 147.1. Purpose.

The purpose of this chapter is to improve the Department's surveillance of the financial condition of insurers by requiring an annual audit by independent certified public accountants of the financial statements reporting the financial condition and the results of operations of insurers.

§ 147.2. Definitions.

The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise:

Audited financial report -- The term includes those items specified in § 147.4 (relating to contents of annual audited financial report).

Commissioner -- The Insurance Commissioner of the Commonwealth.

Department -- The Insurance Department of the Commonwealth.

Independent certified public accountant --

(i) A certified public accountant licensed, or an accounting firm registered, to practice in this Commonwealth under the C.P.A. Law (63 P.S. §§ 9.1 -- 9.16b) or in another state with similar licensing requirements, in good standing with the American Institute of Certified Public Accountants, Inc., and in good standing in the states in which the certified public accountant is licensed or the accounting firm is registered to practice; who conforms to the standards of the profession as contained in the "Code of Professional Ethics of the American Institute of Certified Public Accountants, Inc." and the C.P.A. Law or similar laws.

(ii) For Canadian and British companies, a Canadian-chartered or British-chartered accountant.

Insurer --

(i) The term includes any of the following licensed to transact business in this Commonwealth:

(A) An insurance company, association or exchange.

(B) A reciprocal or interinsurance exchange.

(C) The Inspection Bureau, the Industry Placement Facility and the Fair Plan coming under the Pennsylvania Fair Plan Act (40 P.S. §§ 1600.101 -- 1600.502).

(D) A hospital plan corporation.

(E) A professional health services plan corporation.

(F) A health maintenance organization.

(G) A fraternal benefit society or beneficial association.

(H) Another person, corporation, company, partnership, association or other entity acting as an insurer.

(ii) Except as otherwise noted, the term also includes a continuing care provider licensed to transact business in this Commonwealth.

§ 147.3. Filing and extensions for filing of annual audited financial report.

(a) Every insurer, unless exempted by the Commissioner under § 147.13 (relating to effective date and exemption), shall have an annual audit performed by an independent

certified public accountant and shall file with the Commissioner an audited financial report for that year on or before June 1 for the year ending December 31 immediately preceding unless an extension is granted under subsection (b). The Commissioner may require an insurer to file an audited financial report earlier than June 1 by providing 90 days' advance notice to the insurer.

(b) Extensions of the filing date may be granted by the Commissioner for 30-day periods upon showing, by the insurer or its independent certified public accountant, the reasons for requesting an extension by the Commissioner. The request for extension shall be submitted in writing at least 10 days prior to the due date in sufficient detail to permit the Commissioner to make an informed decision with respect to the requested extension.

(c) Subsections (a) and (b) do not apply to continuing care providers. In accordance with the law and regulations relating to continuing care providers, each continuing care provider shall have an annual audit performed by an independent certified public accountant and shall file with the Commissioner an audited financial report for that year within 4 months following the end of the provider's fiscal year.

(d) Audited financial reports filed with the Commissioner will be open to the public for examination and inspection.

§ 147.4. Contents of annual audited financial report.

(a) The annual audited financial report shall reflect the financial condition of the insurer as of the end of the most recent calendar year and the results of its operations, cash flows and changes in capital and surplus for the year then ended in conformity with statutory accounting practices prescribed, or otherwise permitted, by the Department. Statutory accounting practices are those practices and procedures prescribed by the Accounting Practices and Procedures Manuals published by the National Association of Insurance Commissioners, or as otherwise prescribed or provided by specific statutes, regulations, orders or rulings of the Commonwealth or the Department.

(b) The annual audited financial report shall, at a minimum, include the following:

(1) Financial statements that present in a comparable manner, as of the end of the current and the preceding calendar year, the financial condition of the insurer, including the following

- (i) Balance sheet reporting admitted assets, liabilities, capital and surplus.
- (ii) Statement of operations.
- (iii) Statement of cash flows.
- (iv) Statement of changes in capital and surplus.

(2) Notes to financial statements. These notes shall be those required by the appropriate National Association of Insurance Commissioners Annual Statement Instructions and [other notes required by generally accepted accounting principles and shall include the following:

(i) A] **Accounting Practices and Procedures Manual. The notes shall include a** reconciliation of differences, if any, between the audited statutory financial statements and the annual statements filed **with the Department under section 320 of The Insurance Company Law of 1921 (40 P.S. § 443) and other applicable laws and regulations,** with a written description of the nature of these differences, particularly with respect to surplus or stockholder equity and the results of operations. The insurer shall file an amendment to its annual statement with the Department, the National Association of Insurance Commissioners and other states in which the insurer is licensed, to reflect differences between the audited statutory financial statement and the annual statement filed with the Department within 60 days of the filing date of the audited financial report. The Commissioner may require amendments to financial statements to be filed with the Department and the National Association of Insurance Commissioners on diskettes or other electronic information storage devices acceptable to the Commissioner.

[(ii) A summary of ownership and relationships of the insurer and affiliated companies.]

(3) The report of an independent certified public accountant prepared in compliance with this chapter, including notification of adverse financial condition, report on significant deficiencies in internal controls and letter of qualifications of the independent certified public accountant.

(c) The financial statements included in the audited financial report shall be prepared in a form and using language and groupings substantially the same as the relevant sections of the annual statement of the insurer filed with the Department, and the financial statements shall be comparative, presenting the amounts as of December 31 of the current year and the amounts as of the immediately preceding December 31. In the first year in which an insurer is required to file an audited financial report, the comparative data may be omitted if sufficient detail is made available to the Department upon request. An account which represents less than 5% of the insurer's admitted assets may be aggregated for reporting purposes, except that all invested asset accounts shall be separately reported.

(d) If an error is discovered after a report is filed, the accountant shall withdraw the report and issue a corrected report within 30 days of discovery of the error. To the extent that the error requires an amendment to the insurer's annual financial statement filed with the Department, the insurer shall file an amendment under subsection (b)(2)(i).

§ 147.5. Designation of independent certified public accountant.

(a) Each insurer required by this chapter to file an annual audited financial report shall, within 60 days after becoming subject to the requirement, register with the Commissioner in writing the name and address of the independent certified public accountant or accounting firm retained to conduct the annual audit set forth in this chapter. Insurers which have not retained an independent certified public accountant by November 11, 1995, shall engage and register the name and address of an independent certified public accountant with the Commissioner at least 6 months before the date when the first audited financial report is required to be filed. This subsection does not apply to insurers which registered with the Commissioner in writing the name and address of an independent certified public accountant in compliance with this chapter prior to November 11, 1995.

(b) The insurer shall obtain a letter from its independent certified public accountant and file a copy with the Commissioner, stating that the independent certified public accountant is aware of the provisions of the insurance statutes and regulations that relate to accounting and financial matters of the State in accordance with whose regulation the audited financial report is made and affirming that the independent certified public accountant will express an opinion on the financial statements in terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by the Department, specifying the exceptions the independent certified public accountant may believe appropriate.

(c) If an independent certified public accountant who was the independent certified public accountant for the immediately preceding filed audited financial report is dismissed, resigns or is otherwise replaced, the insurer shall within 5 business days notify the Department of the dismissal, resignation or replacement. Within 10 business days of submitting a notification of dismissal, resignation or replacement, the insurer shall also furnish the Commissioner with a separate letter stating whether, in the 24 months preceding the dismissal, resignation or replacement, there were disagreements with the former independent certified public accountant on a matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of the former independent certified public accountant, would have caused the independent certified public accountant to make reference to the subject matter of the disagreement in connection with the independent certified public accountant's opinion. The disagreements required to be reported include both those resolved to the former independent certified public accountant's satisfaction and those not resolved to the former independent certified public accountant's satisfaction. For purposes of this subsection, disagreements are those that occur at the decision making level -- that is, between personnel of the insurer responsible for presentation of its financial statements and personnel of the accounting firm responsible for rendering the report. The insurer shall also in writing request the former independent certified public accountant to furnish it a letter addressed to the insurer stating whether the independent certified public accountant agrees with the statements

contained in the letter of the insurer and, if not, stating the reasons for which the independent certified public accountant does not agree. The insurer shall furnish the responsive letter from the former independent certified public accountant to the Commissioner together with its own.

§ 147.6 Qualifications of independent certified public accountant.

(a) The Commissioner will not recognize a person as a qualified independent certified public accountant who is not licensed, or a firm which is not registered, to practice and is not in good standing under the laws of the Commonwealth or of a state with licensing requirements similar to the Commonwealth or who is not in good standing with the American Institute of Certified Public Accountants, Inc., and in good standing in all states in which the accountant is licensed or the firm is registered to practice, or, for a Canadian or British company, who is not a chartered accountant.

(b) Except as otherwise provided in this section, an independent certified public accountant will be recognized as independent and qualified who conforms to the standards of the profession as contained in the "Code of Professional Ethics of the American Institute of Certified Public Accountants, Inc." and the C.P.A. Law (63 P.S. §§ 9.1- 9.16b) or similar laws.

(c) A partner or other person responsible for rendering an audited financial report may not act in that capacity for more than 7-consecutive years. Following a 7-year period of service, the person will be disqualified from acting in that or a similar capacity for the same insurer or its insurance subsidiaries or affiliates for 2 years. An insurer may apply to the Commissioner for relief from the rotation requirement on the basis of unusual circumstances. In determining if the relief should be granted, the Commissioner may consider the following factors:

(1) The number of partners, the expertise of the partners or the number of insurance or continuing care provider clients in the currently registered firm.

(2) The premium volume of the insurer or revenue volume of the continuing care provider.

(3) The number of jurisdictions in which the insurer transacts business.

(d) The Commissioner will not recognize as a qualified independent certified public accountant, nor accept an annual audited financial report prepared in whole or in part by a natural person who meets one of the following conditions:

(1) The person has been convicted of fraud, bribery, a violation of 18 U.S.C.A. Chapter 96 (relating to the Racketeer Influenced and Corrupt Organizations) or any dishonest conduct or practice under Federal or state law.

(2) The person has been found to have violated the insurance laws of the Commonwealth with respect to previous reports submitted under this chapter.

(3) The person has demonstrated a pattern or practice of failing to detect or disclose material information in previous reports filed under this chapter.

(e) The Commissioner may hold a hearing in accordance with 2 Pa. C.S. §§ 501 - 508 and 701 -- 704 (relating to Administrative Agency Law) and Chapters 56 -- 58 (relating to special rules of administrative practice and procedure; publication of citations and notice of hearings; and objections and procedure for hearings on reports of examination) to determine whether a certified public accountant is qualified and, considering the evidence presented, may rule that the accountant is not independent or qualified, or both, for purposes of expressing an opinion on the financial statements in the audited financial report made under this chapter and may require the insurer to replace the certified public accountant.

(f) If the Commissioner has reason to believe that an audit performed contains a material departure from generally accepted auditing standards, the Commissioner may refer the matter to the State Board of Accountancy and the American Institute of Certified Public Accountants, Inc., for review and determination. Upon the finding by the State Board of Accountancy or the American Institute of Certified Public Accountants, Inc., that a certified public accountant violated applicable standards relating to competence, the performance of audits, accounting principles or other professional conduct, the Commissioner will not accept the audited financial report for that audit and will no longer accept audited financial statements certified by that certified public accountant.

(g) Within 60 days of receipt of notice from the Commissioner of a finding under subsection (f) that an audit contains a material departure from generally accepted auditing standards, the insurer for which the audit was performed shall register with the Commissioner the name and address of a qualified independent certified public accountant retained by the insurer to perform an audit in compliance with this chapter for the year for which the finding was made. The audited financial report for the year for which the finding was made shall be filed within a time period to be determined by the Commissioner.

§ 147.7 Consolidated or combined audits.

(a) An insurer may make written application to the Commissioner for approval to file audited consolidated or combined financial reports in lieu of separate annual audited financial reports if the insurer is part of a group of insurance companies which utilizes a pooling or 100% reinsurance agreement that affects the solvency and integrity of the insurer's reserves and the insurer cedes all of its direct and assumed business to the pool. A columnar consolidating or combining worksheet, setting forth the amounts shown on the consolidated or combined audited financial report with a reconciliation of differences between the amounts shown in the individual insurer columns of the worksheet and comparable amounts shown on the annual statements of the insurer, shall be filed with

the report. The reconciliation shall include explanations of consolidating and eliminating entries. Noninsurance operations may be shown on the worksheet on a combined or individual basis. Consolidated or combined audited financial reports shall be prepared in conformity with statutory accounting practices as set forth in § 147.4(a) (relating to contents of annual audited financial report).

(b) The Commissioner may require an insurer to file separate annual audited financial reports.

(c) This section does not apply to continuing care providers.

§ 147.8 Scope of audit and report of independent certified public accountant.

The annual financial statements filed by an insurer with the Department shall be audited by an independent certified public accountant. The audit of the financial statements of the insurer shall be conducted in accordance with generally accepted auditing standards. Consideration should also be given to other procedures illustrated in the *Financial Condition Examiners' Handbook* contained in the examiners handbook adopted by the National Association of Insurance Commissioners as the independent certified public accountant deems necessary. The Commissioner may from time to time prescribe that additional auditing procedures be observed by the independent certified public accountant in the audit of the financial statements of insurers under this chapter.

§ 147.9. Notification of adverse financial condition.

(a) An insurer required to furnish the annual audited financial report shall require the independent certified public accountant to report, in writing, within 5 business days to the board of directors or audit committee of the insurer, a determination by that independent certified public accountant that the insurer has materially misstated its financial condition as reported to the Commissioner as of the balance sheet date currently under examination or of a determination that the insurer does not meet its capital and surplus requirement calculated in accordance with Pennsylvania insurance statutes as of that date.

(b) An insurer required by this chapter to file an annual audited financial report who receives any report from the independent certified public accountant, as required by this section, shall forward a copy of the report to the Commissioner within 5 business days of receipt of the report and shall provide the independent certified public accountant making the report with evidence of the report being furnished to the Commissioner. If within the required 5 business day period, the independent certified public accountant does not receive evidence from the insurer of the report being furnished to the Commissioner, the independent certified public accountant shall directly furnish to the Commissioner a copy of the report within the next 5 business days.

(c) The engagement letter executed by the insurer and the independent certified public accountant shall expressly provide that the independent certified public accountant

is not liable in any manner to the insurer for a statement made under subsection (b) if the statement is made in good faith in compliance with that subsection.

(d) If the independent certified public accountant, subsequent to the date of the annual audited financial report filed under this chapter, becomes aware of facts which might have affected the independent certified public accountant's report, the independent certified public accountant is required to take action as prescribed in Volume 1, Section AU 561 of the Professional Standards of the American Institute of Certified Public Accountants, Inc. If, pursuant to the auditing standards for subsequent discovery of facts, the independent certified public accountant advises the insurer to make appropriate disclosure of newly discovered facts, the insurer shall provide the Department with written notice of the independent certified public accountant's advice within 5 business days of receipt of that advice.

§ 147.10. Report on significant deficiencies in internal controls.

(a) Concurrently with the filing of the annual audited financial reports, each insurer shall furnish the Commissioner with a written report prepared by the independent certified public accountant describing significant deficiencies in the insurer's internal control structure noted by the independent certified public accountant during the audit. The Statement of Auditing Standard No. 60, *Communication of Internal Control Structure Matters Noted in an Audit* (AU Section 325 of the Professional Standards of the American Institute of Certified Public Accountants, Inc.) requires an independent certified public accountant to communicate significant deficiencies, known as "reportable conditions," noted during a financial statement audit to the appropriate parties within an entity. A report should not be issued if the independent certified public accountant does not identify significant deficiencies. If significant deficiencies are noted, the written report shall be filed annually by the insurer with the Department within 60 days after the filing of the annual audited financial report.

(b) The insurer is required to provide, within 60 days of the date of the independent certified public accountant's report on significant deficiencies, a description of remedial actions taken or proposed to correct significant deficiencies, if the actions are not described in the independent certified public accountant's report.

§ 147.11. Definitions, availability and maintenance of independent certified public accountant workpapers.

(a) Workpapers are the records kept by an independent certified public accountant of the procedures followed, the tests performed, the information obtained and the conclusions reached pertinent to audit of the financial statements of an insurer. For purposes of this chapter, workpapers include audit planning documentation, audit programs, permanent files, internal control and electronic data processing questionnaires, analyses, memoranda, letters of confirmation and representation, abstracts of company documents and schedules or commentaries which are prepared or obtained by the independent certified public accountant in the course of the independent certified public

accountant's audit of the financial statements of an insurer and which support the opinion thereon.

(b) Every insurer required to file an annual audited financial report under this chapter shall require within the engagement letter the agreement of the independent certified public accountant to make available, through the insurer, for review by Department examiners workpapers prepared in the conduct of the audit, as well as communications related to the audit between the independent certified public accountant and the insurer, including the engagement letter, at the offices of the insurer, at the offices of the independent certified public accountant, at the offices of the Department or at another reasonable place designated by the Commissioner. The insurer shall require that the independent certified public accountant retain the audit workpapers and communications for at least 7 years after the period reported on and agree to make a partner or manager available to the Department upon reasonable request.

(c) In the conduct of the periodic review by Department examiners described in subsection (b), photocopies of pertinent audit workpapers may be made and retained by the Department.

(d) Copies of audit workpapers so obtained in the course of review will be considered part of the record of examination of the Commissioner and will be held as confidential records.

§ 147.12 Examinations.

(a) The Commissioner will determine the nature, scope and frequency of examinations conducted by Department examiners under the laws relating to the conduct of examinations. Examinations may, but need not, cover all aspects of the assets, condition, affairs and operations of the insurer and may include and be supplemented by audit procedures performed by the independent certified public accountant as provided in this chapter. Scheduling of examinations will take into account matters such as early warning test results, changes in management, results of market conduct examinations and annual audited financial reports. The type of examinations performed by Department examiners will be as follows:

(1) Compliance examinations will consist of a review of the workpapers of the independent certified public accountant defined under § 147.11 (relating to definition, availability, and maintenance of independent certified public accountant workpapers) and a general review of the corporate affairs and insurance operations of the insurer to determine compliance with the Pennsylvania insurance statutes and this title. The examiners may perform alternative or additional examination procedures to supplement those performed by the independent certified public accountant when the examiners determine that the procedures are necessary to verify the financial condition of the insurer.

(2) Limited scope examinations may cover areas such as life reserve valuations, claims analyses and organizational and capital changes and other areas as the Commissioner may deem appropriate.

(3) Comprehensive examinations will be performed when the report of the independent certified public accountant as provided for in § 147.8 (relating to scope of audit and report of independent certified public accountant), the notification required by § 147.9 (relating to notification of adverse financial condition), the results of compliance or limited scope examinations, or other circumstances indicate in the judgment of the Commissioner that a complete examination of the condition and affairs of the insurer is necessary.

(b) Upon the completion of each examination described in subsection (a), the examiners appointed by the Commissioner will make a full and true report on the results of the examination. Each report will include a general description of the audit procedures performed by Department examiners and the procedures of the independent certified public accountant which the examiners may have utilized to determine the nature, timing and extent of their examination procedures. The cost of the examination shall be paid by the insurer examined in accordance with the laws and regulations relating to Department examinations.

(c) This chapter does not prohibit, preclude or in any way limit the Commissioner from ordering and conducting, or performing examinations of insurers under the laws and regulations of the Commonwealth and the practices and procedures of the Department.

§ 147.13 Effective date and exemption.

(a) This chapter applies to all insurers doing business in this Commonwealth.

(b) For those insurers retaining an independent certified public accountant on November 11, 1995, the 7-year period of service referred to in § 147.6(c) (relating to qualifications of independent certified public accountant) begins when the independent certified public accountant or other person responsible for rendering the annual audited financial report was first retained or assigned that responsibility. The requirement that an insurer retain the services of a new independent certified public accountant in order to comply with the 7-year rotation provision in § 147.6(c) shall become effective November 11, 1997.

(c) Foreign or alien insurers having direct premiums written in this Commonwealth less than \$1 million in a calendar year and having fewer than 1,000 policyholders or certificateholders of directly written policies in this Commonwealth at the end of that calendar year shall be exempt from this chapter for that year unless the Commissioner makes a specific finding that compliance is necessary for the Commissioner to carry out statutory responsibilities. Foreign insurers having assumed premiums pursuant to contracts or treaties of reinsurance, or both, of \$1 million or more are not exempt.

(d) Domestic insurers having total admitted assets less than \$10 million, direct premium written nationwide less than \$1 million in a calendar year and having fewer than 1,000 policyholders or certificateholders of directly written policies nationwide at the end of that calendar year are exempt from this chapter for that year unless the Commissioner makes a specific finding that compliance is necessary for the Commissioner to carry out statutory responsibilities. Domestic insurers having total admitted assets greater than \$10 million or assumed premiums pursuant to contracts or treaties, or both, of reinsurance of \$1 million or more are not exempt.

(e) Insurers domiciled in this Commonwealth and not transacting the business of insurance outside of this Commonwealth having total admitted assets less than \$10 million and either direct premium written of less than \$1 million in a calendar year or fewer than 1,000 policyholders or certificateholders of directly written policies at the end of that calendar year are exempt from this chapter for that year, unless the Commissioner makes a specific finding that compliance is necessary for the Commissioner to carry out statutory responsibilities. Insurers having total admitted assets greater than \$10 million or assumed premiums pursuant to contracts or treaties of reinsurance, or both, of \$1 million or more are not exempt.

(f) Foreign or alien insurers filing annual audited financial reports in another state, pursuant to that state's requirements for annual audited financial reports whose requirements have been found by the Commissioner to be substantially similar to the requirements of this chapter, are exempt from this chapter if the insurer meets the following conditions:

(1) A copy of the annual audited financial report, report of evaluation of accounting procedures and system of internal controls, report on significant deficiencies in internal controls, and the independent certified public accountant's letter of qualifications which are filed with the other state are filed with the Commissioner in accordance with the filing dates specified in this chapter. Canadian insurers may submit independent certified public accountant's reports as filed with the Canadian Dominion Department of Insurance.

(2) A copy of a notification of adverse financial condition report filed with the other state is filed with the Commissioner within the time frames specified in § 147.9 (relating to notification of adverse financial condition).

(g) Upon written application of an insurer, the Commissioner may grant an exemption from compliance with this chapter if the Commissioner finds, upon review of the application, that compliance with this chapter would constitute a financial or organizational hardship upon the insurer. An exemption may be granted at any time and from time to time for specified periods. Within 10 days from a denial of the written request of an insurer for an exemption from this chapter, the insurer may request in writing a hearing on its application for an exemption. Hearings will be held in accordance with 2 Pa.C.S. §§ 501 -- 508 and 701 -- 704 (relating to Administrative

Agency Law) and Chapters 56 -- 58 (relating to special rules of administrative practice and procedure; publication of citations and notice of hearings; and objections and procedure for hearings on reports of examinations).

(h) Subsections (c) -- (g) do not apply to continuing care providers.

(i) Domestic insurers retaining an independent certified public accountant on November 11, 1995, shall comply with this chapter for the year ending December 31, 1995, and each year thereafter unless the Commissioner permits otherwise.

(j) Foreign insurers shall comply with this chapter for the year ending December 31, 1995, and each year thereafter, unless the Commissioner permits otherwise.

(k) In the case of Canadian and British insurers, the annual audited financial report is defined as the annual statement of total business on the form filed by the insurers with their domiciliary supervision authority, audited by an independent chartered accountant. For these insurers, the letter required in § 147.15 (relating to letter of qualifications of independent certified public accountant) shall state that the independent certified public accountant is aware of the requirements relating to the annual audited financial report filed with the Commissioner under § 147.3 (relating to filing and extensions for filing of annual audited financial reports) and shall affirm that the opinion expressed is in conformity with those requirements.

§ 147.14 Penalties.

Failure to file the annual audited financial report and additional statements, letters or reports required by this chapter or failure to comply with § 147.11 (relating to definition, availability and maintenance of independent certified public accountant workpapers) will subject the insurer to the penalties provided by law.

§ 147.15 Letter of qualifications of independent certified public accountant.

The independent certified public accountant shall furnish the insurer for inclusion in the filing of the annual audited financial report a letter including the following:

(1) A statement that the certified public accountant is independent with respect to the insurer and conforms to the standards of the profession as contained in the Code of Professional Ethics and pronouncements of the American Institute of Certified Public Accountants, Inc., and the C.P.A. Law (63 P.S. §§ 9.1 -- 9.16(b)) or similar laws.

(2) A description of the background and experience in general and the experience in audits of insurers of the staff assigned to the engagement and whether each staff person is an independent certified public accountant. This chapter does not prohibit the independent certified public accountant from utilizing staff as the independent certified public accountant deems appropriate when consistent with the standards prescribed by generally accepted auditing standards.

(3) A statement that the independent certified public accountant understands that the annual audited financial report and the independent certified public accountant's opinion thereon will be filed in compliance with this chapter and that the Commissioner will be relying on this information in the monitoring and regulation of the financial position of insurers.

(4) A statement that the independent certified public accountant consents to the requirements of § 147.11 (relating to definitions, availability and maintenance of independent certified public accountant workpapers) and that the independent certified public accountant consents and agrees to make available for review by the Commissioner, the Commissioner's designee or Department examiners, the workpapers, as defined in § 147.11.

(5) A representation that the independent certified public accountant is properly licensed by an appropriate state licensing authority and is a member in good standing in the American Institute of Certified Public Accountants, Inc.

(6) A representation that the independent certified public accountant is in compliance with § 147.6 (relating to qualifications of independent certified public accountant).



**COMMONWEALTH OF PENNSYLVANIA
INSURANCE DEPARTMENT**

OFFICE OF SPECIAL PROJECTS
1326 Strawberry Square
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February 22, 2001

Mr. Robert Nyce
Executive Director
Independent Regulatory Review Comm.
333 Market Street
Harrisburg, PA 17101

Re: Insurance Department Final
Form Regulation No. 11-203,
Annual Audited Insurers'
Financial Report Required

Dear Mr. Nyce:

Pursuant to Section 5a(c) of the Regulatory Review Act, enclosed for your review and approval is final form regulation 31 Pa. Code, Chapter 147, Annual Audited Insurers' Financial Report Required.

The purpose of this rulemaking is to update Chapter 147, commonly referred to as the CPA Audit Rule, to reflect current statutory accounting practices and procedures adopted by the National Association of Insurance Commissioners (NAIC). The regulation prescribes requirements for annual audits of financial statements filed by insurers with the Department. The regulation was adopted in 1979 and last amended November 11, 1995. The regulation is based on a model regulation adopted by the NAIC and are included in the NAIC's state accreditation standards for regulation of the financial solvency of the insurance industry. In 1998 the NAIC revised the model regulation to make it consistent with the NAIC's codified *Accounting Practices and Procedures Manual* (manual) effective January 1, 2001. Insurers subject to this regulation have been advised by Insurance Department Notice Nos. 1998-04 and 2000-02 that they will be required to adhere to the manual in preparing financial statements to be filed with the Department. This rulemaking will update the regulation to be consistent with the manual and the 1998 revisions to the NAIC model regulation.

If you have any questions regarding this matter, please contact me at (717) 787-4429.

Sincerely yours,

A handwritten signature in cursive script that reads "Peter J. Salvatore".

Peter J. Salvatore
Regulatory Coordinator

**TRANSMITTAL SHEET FOR REGULATIONS SUBJECT TO THE
REGULATORY REVIEW ACT**

I.D. NUMBER: 11-203
 SUBJECT: Annual Audited Insurers' Financial Report Required
 AGENCY: DEPARTMENT OF INSURANCE # 2150

TYPE OF REGULATION

- Proposed Regulation
- X Final Regulation
- Final Regulation with Notice of Proposed Rulemaking Omitted
- 120-day Emergency Certification of the Attorney General
- 120-day Emergency Certification of the Governor
- Delivery of Tolled Regulation
 - a. With Revisions
 - b. Without Revisions

RECEIVED
 2001 FEB 22 11:11:32
 INDEPENDENT REGULATORY REVIEW COMMISSION

FILING OF REGULATION

| DATE | SIGNATURE | DESIGNATION |
|---------|-------------------------|--|
| 2/22/01 | <i>Sheila Eckhart</i> | HOUSE COMMITTEE ON INSURANCE |
| 2/22/01 | <i>Deborah Mitchell</i> | SENATE COMMITTEE ON BANKING & INSURANCE |
| 2/22/01 | <i>Rina Eckhart</i> | INDEPENDENT REGULATORY REVIEW COMMISSION |
| | | ATTORNEY GENERAL |
| | | LEGISLATIVE REFERENCE BUREAU |