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| Regulatory Analysis Form | | This space for use by IRRC <div style="text-align: right;">2004 FEB -2 PM 4:18</div> <div style="text-align: right; font-size: small;">REVIEW COMMISSION</div> |
| (1) Agency Insurance Department | | IRRC Number: 2384 |
| (2) I.D. Number (Governor's Office Use) 11-217 | | |
| (3) Short Title Annual Audited Insurers' Financial Report Required | | |
| (4) PA Code Cite 31 Pa. Code, Chapter 147 §§147.1-147.15 | (5) Agency Contacts & Telephone Numbers Primary Contact: Peter J. Salvatore, Regulatory Coordinator, 1326 Strawberry Square, Harrisburg, PA 17120, (717) 787-4429 Secondary Contact: Elaine M. Leitzel, Program Analyst, Office of Regulation of Companies, 1345 Strawberry Square, Harrisburg, PA 17120 (717) 787-8840 | |
| (6) Type of Rulemaking (check one) <input checked="" type="checkbox"/> Proposed Rulemaking <input 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." Chapter 147 requires insurers to have annual audits of their year-end financial statements performed by independent certified public accountants (CPAs). The annual audited financial reports are required to be filed with the Department by June 1 each year. Chapter 147 was adopted in 1979 and is based on a model regulation developed by the National Association of Insurance Commissioners (NAIC). The model is included in the NAIC Financial Regulation Standards and Accreditation Program, which was established in 1989 to set minimum standards for state regulation of the financial solvency of the insurance industry. The Department has been accredited by the NAIC for compliance with the standards since 1994. Chapter 147 was last amended in 1995 to bring it into compliance with changes to the NAIC model. The NAIC model was again revised in 2002 to address concerns about the use of indemnification clauses in the engagement of CPAs for the annual audits. In 2003 an additional revision was made to specifically require CPAs to adhere to applicable NAIC instructions and procedures in conducting audits. The updates in this rulemaking include the 2002 and 2003 revisions to the NAIC model, as well as other revisions to improve the clarity of Chapter 147, particularly with respect to its applicability to continuing care providers. | | |
| (9) State the statutory authority for the regulation and any relevant state or federal court decisions. The rulemaking is proposed 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; sections 320, 1007, 2452 and 630 of The Insurance Company Law of 1921 (40 P.S. §§ 443, 967, 991.2452 and 764a) relating to the authority of the Insurance Commissioner (Commissioner) to require insurance companies, associations, exchanges, fraternal benefit societies and preferred provider organizations to file statements concerning their affairs and financial condition; and sections 205 and 206 of The Pennsylvania Fair Plan Act (40 P.S. §§ 1600.205 and 1600.206); section 731 of the Medical Care Availability and Reduction of Error (Mcare) Act (40 P.S. § 1303.731); 40 Pa.C.S. §§ 6125, 6331 and 6701 (relating to reports and examinations; and regulation); sections 11 and 14 of the HMO Act (40 P.S. §§ 1561 and 1564); sections 7 and 25 of the Continuing-Care Provider Registration and Disclosure Act (40 P.S. §§ 3207 and 3225) which respectively, relate to the specific regulatory and rulemaking authority of the Department regarding financial reporting by the Pennsylvania Fair Plan, the Pennsylvania Professional Liability Joint Underwriting Association, hospital plan corporations, professional health service corporations, beneficial associations, health maintenance organizations and continuing care providers. | | |

Regulatory Analysis Form

(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 is needed to strengthen requirements relating to the engagement of CPAs to conduct annual audits of financial statements filed by insurers and continuing care providers and to clarify out-dated or unclear requirements.

(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 this rulemaking.

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

Licensed insurers, continuing care providers and CPAs will benefit from the improved clarity and efficiency of the regulation. The general public will benefit to the extent that these improvements enhance compliance with regulatory and accounting profession standards for financial statements filed by licensed entities with the Department.

Regulatory Analysis Form

(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 adverse effects are anticipated as a result of this rulemaking.

(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 licensed insurers (including health maintenance organizations and preferred provider organizations) and continuing care providers will be required to comply with the regulation. CPAs who wish to conduct audits of financial statements filed by these entities with the Department will be required to meet the qualification requirements of the regulation and agree to its terms and conditions in engagements to conduct the audits. There are 117 licensed continuing care providers and over 1,700 licensed insurers, about 315 of which are domestic insurers.

(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.

Comments on these regulations were requested from The Insurance Federation of Pennsylvania, Inc., The Pennsylvania Association of Mutual Insurance Companies, the Managed Care Association of Pennsylvania, the Pennsylvania Fraternal Congress and consultants to the fraternal industry, the Pennsylvania Association of Nonprofit Homes for the Aging, the Pennsylvania Institute of Certified Public Accountants, Highmark, Inc., Capital Blue Cross, Independence Blue Cross, and Blue Cross of Northeastern Pennsylvania. The comments received were considered in the development of the proposed rulemaking. 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 updated requirements in this regulation will impose no significant additional costs on the regulated community.

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 are no costs or savings to local governments associated with this rulemaking.

(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.

The efficiency of the Department's review of financial statements filed by insurers and continuing care providers and the conduct of on-site financial examinations of domestic insurers and continuing care providers will be improved to the extent this rulemaking improves the clarity of regulatory requirements and promotes the reliability of financial statements filed by these entities.

Regulatory Analysis Form

(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.

| | 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.

There are no significant measurable costs or savings associated with this rulemaking.

Regulatory Analysis Form

(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.

This rulemaking will impose no significant additional costs on affected parties or the Department. Insurers, continuing care providers and CPAs will benefit from the improved clarity and efficiency of the regulation. The general public will benefit to the extent that these improvements enhance compliance with regulatory and accounting profession standards for financial statements filed with the Department.

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

This rulemaking is the most efficient means to establish requirements for annual audits of financial statements filed by insurers and continuing care providers with the Department.

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

This rulemaking updates an existing regulation. No other regulatory schemes were considered.

Regulatory Analysis Form

(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.

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

The regulation is substantially similar to a model regulation developed by the NAIC. The model regulation is included in the NAIC Financial Regulation Standards and Accreditation Program, and the updates to prohibit indemnification agreements in the engagement of CPAs have been proposed for inclusion in those standards. Either the model or similar requirements have been adopted by all other states. This rulemaking 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.

This rulemaking updates an existing regulation of the promulgating agency. In addition, the Department has developed a companion rulemaking, Insurance Department 11-220, to update Chapter 151 (relating to continuing care providers) by replacing out-dated incomplete provisions relating to annual audits in § 151.7(d) with a reference to Chapter 147. The provisions in § 151.7(d) are not needed in addition to the requirements in Chapter 147. No other regulations are affected.

(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 are anticipated.

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.

The rulemaking may reduce paperwork to the extent it allows the affected parties to provide information to the Department in electronic form.

(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.




The rulemaking includes provisions developed to meet the particular needs of the 117 continuing care providers subject to the regulation.

(30) What are 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 regulation 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.

All Department regulations are reviewed for continued effectiveness on a triennial basis.

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| <p>CDL-1</p> <p style="text-align: center;">FACE SHEET FOR FILING DOCUMENTS WITH THE LEGISLATIVE REFERENCE BUREAU</p> <p style="text-align: center;">(Pursuant to Commonwealth Documents Law)</p> | | <p style="text-align: center;">RECEIVED 2004 FEB -2 PM 4:18 LEGISLATIVE COUNCIL REVIEW COMMISSION</p> |
| <p># 2384</p> | | <p>DO NOT WRITE IN THIS SPACE</p> |
| <p>Copy below is hereby approved as to form and legality. Attorney General</p> <p style="text-align: center;"> (Deputy Attorney General)</p> <p style="text-align: center;">JAN 20 2004</p> <p style="text-align: center;">Date of Approval</p> <p>→ Check if applicable. Copy not approved. Objections attached.</p> | <p>Copy below is hereby certified to be a true and correct copy of a document issued, prescribed or promulgated by:</p> <p style="text-align: center;">Insurance Department</p> <p style="text-align: center;">(AGENCY)</p> <p>DOCUMENT/FISCAL NOTE NO. <u>11-217</u></p> <p>DATE OF ADOPTION: _____</p> <p>BY:  M. Diane Koken Insurance Commissioner</p> <p>TITLE: _____ (EXECUTIVE OFFICER, CHAIRMAN OR SECRETARY)</p> | <p>Copy below is hereby approved as to form and legality. Executive or Independent Agencies</p> <p>BY: </p> <p style="text-align: center;"><u>12/1/03</u> DATE OF APPROVAL</p> <p style="text-align: center;">(DEPUTY GENERAL COUNSEL) (CHIEF COUNSEL, INDEPENDENT AGENCY) (STRIKE INAPPLICABLE TITLE)</p> <p>→ Check if applicable. No Attorney General approval or objection within 30 days after submission.</p> |

NOTICE OF PROPOSED RULEMAKING

INSURANCE DEPARTMENT

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

ANNUAL AUDITED INSURERS' FINANCIAL REPORT REQUIRED

PREAMBLE

The Insurance Department (Department) proposes to amend Chapter 147 (relating to annual audited insurers' financial report required) to read as set forth in Annex A. The rulemaking is proposed 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; sections 320, 1007, 2452 and 630 of The Insurance Company Law of 1921 (40 P.S. §§ 443, 967, 991.2452 and 764a) relating to the authority of the Insurance Commissioner (Commissioner) to require insurance companies, associations, exchanges, fraternal benefit societies and preferred provider organizations to file statements concerning their affairs and financial condition; and sections 205 and 206 of The Pennsylvania Fair Plan Act (40 P.S. §§ 1600.205 and 1600.206); section 731 of the Medical Care Availability and Reduction of Error (Mcare) Act (40 P.S. § 1303.731); 40 Pa.C.S. §§ 6125, 6331 and 6701 (relating to reports and examinations; and regulation); sections 11 and 14 of the HMO Act (40 P.S. §§ 1561 and 1564); sections 7 and 25 of the Continuing-Care Provider Registration and Disclosure Act (40 P.S. §§ 3207 and 3225) which respectively, relate to the specific regulatory and rulemaking authority of the Department regarding financial reporting by the Pennsylvania Fair Plan, the Pennsylvania Professional Liability Joint Underwriting Association, hospital plan corporations, professional health service corporations, beneficial associations, health maintenance organizations and continuing care providers.

Purpose

The purpose of this rulemaking is to update Chapter 147, commonly referred to as the "CPA Audit Rule." Chapter 147 requires insurers to have annual audits of their year-end financial statements performed by independent certified public accountants (CPAs). The annual audited financial reports are required to be filed with the Department by June 1 each year. Chapter 147 was adopted in 1979 and is based on a model regulation developed by the National Association of Insurance Commissioners (NAIC). The model is included in the NAIC Financial Regulation Standards and Accreditation Program, which was established in 1989 to set minimum standards for state regulation of the financial solvency of the insurance industry. The Department has been accredited by the NAIC for compliance with the standards since 1994. Chapter 147 was last amended in 1995 to bring it into compliance with changes to the NAIC model. The NAIC model was again revised in 2002 to address concerns about the use of indemnification clauses in the engagement of CPAs for the annual audits. In 2003 an additional revision was made to specifically require CPAs to adhere to applicable NAIC instructions and procedures in conducting audits. The updates in this rulemaking include the 2002 and 2003 revisions to the NAIC model, as well as other revisions to improve the clarity of Chapter 147, particularly with respect to its applicability to continuing care providers.

Significant Provisions

Section 147.2 (relating to definitions) is being amended to add definitions of "domestic insurer" and "foreign insurer" to clarify the meaning of these terms for

purposes of the chapter. In addition, the definition of “independent certified public accountant” and §147.13(i) (relating to effective date and exemption) are being amended to clarify the current reference to “Canadian and British companies.” The definition of “insurer” is being updated to reflect statutory changes relating to the types of entities regulated by the Department; add preferred provider organizations, employers’ mutual liability insurance associations and the Pennsylvania Professional Liability Joint Underwriting Association; and delete the general reference to other entities acting as insurers. These changes are needed to clearly apply Chapter 147 to all types of insurers.

Sections 147.3(a) and (d) (relating to filing and extensions for filing of annual audited financial report), 147.4(b)(2) (relating to contents of annual audited financial report), and 147.13(f)(1) are being amended to recognize movement toward electronic filings with the Department and the NAIC. A related amendment to § 147.11(c) (relating to definitions, availability and maintenance of independent certified public accountant workpapers) refers to the Department’s ability to make and retain electronic copies of audit workpapers when conducting on-site financial examinations of insurers. In addition, § 147.4(d) is being amended to clarify what is required when errors are discovered after an annual audited financial report has been filed. Finally, § 147.4(e) is being added to outline the requirements for non-profit and for-profit continuing care providers under generally accepted accounting principles.

Other amendments to clarify requirements relating to continuing care providers include the addition of § 147.5(d) (relating to designation of independent certified public accountant), the expansion of § 147.7(c) (relating to consolidated or combined audits), the addition of § 147.8(c) (relating to scope of audit and report of independent certified public accountant), and the amendments to § 147.9(a) (relating to notification of adverse financial condition). These amendments are needed to recognize the differences in accounting and financial reporting requirements for insurers and continuing care providers.

Section 147.6 (relating to qualifications of independent certified public accountant) is being amended to include provisions consistent with the 2002 revisions to the NAIC model. The amendments prohibit a CPA from being recognized by the Department as qualified to conduct audits if the CPA’s engagement with the insurer includes an agreement of indemnity, or other release from liability, that would shift, transfer or limit the CPA’s potential liability for failure to adhere to applicable auditing or professional standards based on a defense that misrepresentations were made by the insurer. Also consistent with the changes made to the model is a related amendment to add § 147.6 (g) permitting an insurer and a CPA to agree to have disputes resolved by mediation or arbitration, except that the agreement may be disavowed in a receivership proceeding. These amendments to the model were supported by the insurance industry and are being considered for inclusion in the NAIC Financial Regulation Standards and Accreditation Program. The new provisions are similar to SEC requirements that already apply to publicly held stock insurers. Therefore, the amendments to § 147.6 will establish consistent requirements for all types of insurers. Finally, a reference to the Public Company Accounting Oversight Board has been added to § 146.6(a)(2). The

board was created by the Sarbanes-Oxley Act of 2002 to oversee the audits of public companies.

Section 147.8 (relating to scope of audit and report of independent certified public accountant) is being amended to strengthen requirements relating to the procedures followed by CPAs in conducting audits. The amendments are consistent with revisions made in 2003 to the NAIC model. These changes require the CPA to follow or consider NAIC instructions and procedures relating to the scope of an audit and data testing procedures. The amendments are needed to assure that consistent, up-to-date procedures are followed in the conduct of audits.

Section 147.10(a) (relating to report on significant deficiencies in internal controls) is being amended to clarify the time frame for providing the Department with reports describing any significant deficiencies in an insurer's internal control structure. The reports are required to be filed "concurrently with the filing of the annual audited financial reports" as stated in the beginning of subsection (a). The amendment clarifies the requirement by deleting the last sentence of subsection (a), which refers to a 60-day time frame.

Section 147.11(b) (relating to definitions, availability and maintenance of independent certified public accountant workpapers) is being amended to delete the requirement that the engagement letter include the CPA's agreement to make workpapers available to the Department as required under § 147.11. This requirement is not needed in addition to the requirement in § 147.15(4) (relating to the letter of qualifications of independent certified public accountant) that the CPA's consent to comply with § 147.11 be included in the letter of qualifications furnished to the insurer. Requiring the CPA's consent to these requirements in the letter of qualifications is consistent with the NAIC model.

Section 147.13 (relating to effective date and exemption) is being amended to update references to other sections in the chapter to reflect the impact of the proposed amendments. In addition, § 147.13(e) is being amended to replace "not transacting the business of insurance outside of this Commonwealth" with the clearer phrase "not insuring or reinsuring risks located outside of this Commonwealth" and to reflect the new definitions for "domestic insurer" and foreign insurer." Subsections 147.13(i) and (j) are being deleted. These subsections established time frames for achieving compliance with the chapter when it was adopted in 1995 and are no longer needed.

External Comments

In drafting this proposed rulemaking, the Department requested comments from The Insurance Federation of Pennsylvania, Inc., The Pennsylvania Association of Mutual Insurance Companies, the Managed Care Association of Pennsylvania, the Pennsylvania Fraternal Congress and consultants to the fraternal industry, the Pennsylvania Association of Nonprofit Homes for the Aging, the Pennsylvania Institute of Certified Public Accountants, Highmark, Inc., Capital Blue Cross, Independence Blue Cross, and Blue

Cross of Northeastern Pennsylvania. The comments received in response to the Department's request were considered in the development of this rulemaking.

Affected Parties

The chapter applies to all types of insurers and continuing care providers licensed to transact business in this Commonwealth and the CPAs retained by these entities to conduct audits of their annual financial statements.

Fiscal Impact

State Government

The rulemaking will clarify and strengthen existing regulatory requirements. There will be no increase in cost to the Department as a result of this rulemaking.

General Public

The rulemaking has no fiscal impact on the general public.

Political Subdivisions

There will be no fiscal impact on political subdivisions as a result of the rulemaking.

Private Sector

The strengthened requirements in this rulemaking are consistent with NAIC standards and will impose no significant costs on insurers and continuing care providers in obtaining annual audits of their financial statements.

Paperwork

The rulemaking will not impose additional paperwork on the Department and affected parties. The rulemaking may reduce paperwork to the extent that it provides for the filing of documents in electronic form.

Effectiveness/Sunset Date

The rulemaking will become effective upon final adoption and publication in the *Pennsylvania Bulletin* as final-form rulemaking. The Department continues to monitor the effectiveness of regulations on a triennial basis; therefore no sunset date has been assigned.

Contact Person

Questions or comments regarding the proposed rulemaking may be addressed in writing to Peter J. Salvatore, Regulatory Coordinator, Insurance Department, 1326 Strawberry Square, Harrisburg, PA 17120, within 30 days following the publication of this notice in the *Pennsylvania Bulletin*. Questions and comments may also be e-mailed to psalvatore@state.pa.us or faxed to (717) 772-1969.

Under the Regulatory Review Act (71 P.S. §§ 745.1—745.15), the Department is required to write to all commentators, requesting whether or not they wish to receive a copy of the final-form rulemaking. To better serve our stakeholders, the Department has made a determination that all commentators will receive a copy of the final-form rulemaking when it is made available to the Independent Regulatory Review Commission (IRRC) and the legislative standing committees.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P.S. § 745.5(a)), on February 2, 2004, the Department submitted a copy of this proposed rulemaking to the Independent Regulatory Review Commission (IRRC) and to the Chairpersons of the Senate Banking and Insurance Committee and the House Insurance Committee. In addition to the submitted proposed rulemaking, the Department has, as required by the Regulatory Review Act, provided IRRC and the Committees with a copy of a detailed Regulatory Analysis Form prepared by the Department. A copy of that material is available to the public upon request.

IRRC will notify the Department of any objections to any portion of the proposed rulemaking within 30 days of the close of the public comment period. The notification shall specify the regulatory review criteria that have not been met by that portion. The Regulatory Review Act specifies detailed procedures for the Department, the Governor, and the General Assembly to review these objections before final publication of the regulations.

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.

| | |
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| 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 or 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 for 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.

Domestic insurer—An insurer incorporated or organized under the laws of the Commonwealth.

Foreign insurer—An insurer not incorporated or organized under the laws 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] **insurers organized in Canada or the United Kingdom of Great Britain and Northern Ireland, a 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.] **A nonprofit health plan corporation, whether operating a hospital plan or a professional health services plan, or both.**

(E) [A professional health services plan corporation.] **An employers' mutual liability insurance association.**

(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.] **A preferred provider organization.**

(I) A joint underwriting association under section 731 of the Medical Care Availability and Reduction of Error (Mcare) Act (40 P.S. § 1303.731).

(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] **as instructed by** 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. **The Commissioner may require audited financial reports and related information required under this chapter to be filed with the Department and the National Association of**

Insurance Commissioners in a form of electronic transmission acceptable to the Commissioner.

(b) Extensions of the filing date may be granted by the Commissioner for 30-day periods upon showing, by the insurer and 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] **as instructed by** 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 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, 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] **in a form of electronic transmission** acceptable to the Commissioner.

(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 independent certified public accountant shall withdraw the report and issue a corrected report to the insurer and to the Department within 30 days of the date the independent certified public accountant becomes aware of the 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, within 60 days of the date the corrected report is issued, an amendment [under subsection (b)(2)] 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 corrected audited statutory financial statement and the annual statement filed with the Department and including reconciling notes as required by the appropriate

National Association of Insurance Commissioners Annual Statement Instructions and Accounting Practices and Procedures Manual. The Commissioner may require amendments to financial statements to be filed with the Department and the National Association of Insurance Commissioners in a form of electronic transmission acceptable to the Commissioner.

(e) Subsections (a)—(d) do not apply to continuing care providers. The annual audited financial report for a continuing care provider shall comply with the following:

(1) The annual audited financial report for a nonprofit continuing care provider shall reflect its financial condition as of the end of its most recent fiscal year and the results of its activities, cash flows and changes in net assets for the fiscal year then ended in conformity with generally accepted accounting principles. The annual audited financial report shall, at a minimum, include the following:

(i) Financial statements that present in a comparable manner, as of the end of the current and the preceding fiscal year, or the period of time that the continuing care provider has been in existence, whichever is shorter, the financial condition of the continuing care provider, including balance sheet, statements of activities, cash flows, changes in net assets and notes to financial statements.

(ii) 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.

(2) The annual audited financial report for a for-profit continuing care provider shall reflect its financial condition as of the end of its most recent fiscal year and the

results of its operations, cash flows and changes in shareholder's equity for the year then ended in conformity with generally accepted accounting principles. The annual audited financial report shall, at a minimum, include the following:

(i) Financial statements that present in a comparable manner, as of the end of the current and the preceding fiscal year, or the period of time that the continuing care provider has been in existence, whichever is shorter, the financial condition of the continuing care provider, including balance sheet, statements of net income, cash flows, shareholder's equity and comprehensive income, and notes to financial statements.

(ii) 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.

(3) If an error is discovered after an annual audited financial report is filed, the independent certified public accountant shall withdraw the report and issue a corrected report within 30 days of the date the independent certified public accountant becomes aware of the discovery of the error.

§ 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.

(d) Subsection (b) does not apply to continuing care providers. A continuing care provider 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 Commonwealth's statutes and regulations that relate to accounting and financial matters applicable to continuing care providers and affirming that the independent certified public accountant will express an opinion on the financial statements in terms of their conformity with generally acceptable accounting principles.

§ 147.6. Qualifications of independent certified public accountant.

(a) The Commissioner will not recognize a person **or firm** 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. under any of the following conditions:

(1) The person is not licensed, or the firm 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.

(2) The person or firm is not in good standing with the American Institute of Certified Public Accountants, Inc. and, if applicable, the Public Company Accounting Oversight Board.

(3) The person or firm is not in good standing in all States in which the person is licensed, or the firm is registered, to practice.

(4) The person or firm has entered into an agreement of indemnity, or other release from liability, that would shift, transfer, or limit in any manner the potential liability of the person or firm for failure, whether by omission or commission, to adhere to applicable auditing or professional standards, whether or not the failure would result in whole or in part from misrepresentations made by the insurer or its representatives.

(b) For an insurer organized in Canada or the United Kingdom of Great Britain and Northern Ireland, the Commissioner will not recognize a person or firm as a qualified independent public accountant under any of the following conditions:

(1) The person or firm is not a chartered accountant.

(2) The person or firm has entered into an agreement of indemnity, or other release from liability, that would shift, transfer, or limit in any manner the potential liability of the person or firm for failure, whether by omission or commission, to adhere to applicable auditing or professional standards, whether or not the failure would result in whole or in part from misrepresentations made by the insurer or its representatives.

[(b)] **(c)** Except as otherwise provided in this section, **the Commissioner will recognize** 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)] **(d)** 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)]~~ **(e)** 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)]~~ **(f)** 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.

(g) A qualified independent certified public accountant may enter into an agreement with an insurer to have disputes relating to an audit resolved by mediation or arbitration. However, in the event of a receivership proceeding commenced against the insurer under Article V of The Insurance Department Act (40 P.S. §§ 221.1—221.63), the mediation or arbitration agreement may be disavowed by the statutory receiver.

~~[(f)]~~(h) 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)]~~(i) Within 60 days of receipt of notice from the Commissioner of a finding under subsection ~~[(f)]~~ (h) 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] **Subsection (a)** does not apply to continuing care providers. **A continuing care provider may make written application to the Commissioner for approval to file consolidated or combined financial reports in lieu of separate annual audited financial reports if the continuing care provider is part of a group of affiliated entities. A columnar consolidating or combining worksheet, setting forth the amounts shown for each individual entity on the consolidated or combined audited financial report and including explanations of consolidating and eliminating entries, shall be filed with the report. Consolidated or combined audited financial reports shall be prepared as set forth in § 147.4(e) (relating to contents of annual audited financial report).**

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

(a) 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 Examiner's*

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.]

(b) The scope of the audit and data testing procedures shall be conducted as required by the appropriate *Annual Statement Instructions* adopted by the National Association of Insurance Commissioners. Consideration shall also be given to other procedures in the *Financial Condition Examiner's Handbook* adopted by the National Association of Insurance Commissioners.

(c) Subsection (b) does not apply to continuing care providers.

(d) 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.] **any of the following:**

(1) A determination by the 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 being audited.

(2) A determination by the independent certified public accountant that the insurer does not meet its capital and surplus requirement, or that the continuing care provider does not meet its liquid reserve requirement, under laws and regulations relating to the insurer or continuing care provider as of the balance sheet date currently being audited.

(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), electronic copies or 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 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)] **(d)** (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)](d) 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]Domestic insurers not insuring or reinsuring risks located 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] **as instructed by** 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)](i) In the case of [Canadian and British] insurers organized in Canada or the United Kingdom of Great Britain and Northern Ireland, 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**

**SPECIAL PROJECTS OFFICE
1326 Strawberry Square
Harrisburg, PA 17120**

**Phone: (717) 787-4429
Fax: (717) 772-1969
E-mail: psalvatore@state.pa.us**

February 2, 2004

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

Re: Insurance Department Proposed Regulation No. 11-217, Annual Audited Insurers' Financial
Report Required

Dear Mr. Nyce:

Pursuant to Section 5(a) of the Regulatory Review Act, enclosed for your information and review is
proposed regulation 31 Pa. Code, Chapter 147.

The purpose of this rulemaking is to update Chapter 147, commonly referred to as the "CPA Audit Rule." Chapter 147 requires insurers to have annual audits of their year-end financial statements performed by independent certified public accountants (CPAs). In 2003 an additional revision was made to specifically require CPAs to adhere to applicable NAIC instructions and procedures in conducting audits. The updates in this rulemaking include the 2002 and 2003 revisions to the NAIC model, as well as other revisions to improve the clarity of Chapter 147, particularly with respect to its applicability to continuing care providers.

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

Sincerely yours,

A handwritten signature in cursive script, reading "Peter J. Salvatore".

Peter J. Salvatore
Regulatory Coordinator

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

I.D. NUMBER: 11-217

SUBJECT: Annual Audited Insurers' Financial Report Required

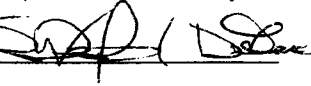
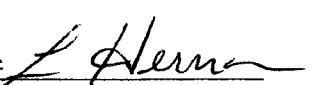

AGENCY: DEPARTMENT OF INSURANCE

TYPE OF REGULATION

- X Proposed Regulation
- 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
FEB -2 PM 4:10
REGULATORY REVIEW ACT

FILING OF REGULATION

| DATE | SIGNATURE | DESIGNATION |
|--------|---|--|
| 2-2-04 |  | HOUSE COMMITTEE ON INSURANCE |
| 2-2-04 |  | |
| 2-2-04 |  | SENATE COMMITTEE ON BANKING & INSURANCE |
| 2/2/04 |  | |
| 2/2/04 |  | INDEPENDENT REGULATORY REVIEW COMMISSION |
| | | ATTORNEY GENERAL (for Final Omitted only) |
| 2/2/04 |  | LEGISLATIVE REFERENCE BUREAU (for Proposed only) |

January 22, 2004