

Regulatory Analysis Form

(Completed by Promulgating Agency)



IRRC

Independent Regulatory Review Commission

SECTION I: PROFILE

(1) Agency:

Insurance

(2) Agency Number:

11-238

IRRC Number: 2740

(3) Short Title:

Annual Financial Reporting Requirements

(4) PA Code Cite:

31 Pa. Code, Chapter 147

(5) Agency Contacts (List Telephone Number, Address, Fax Number and Email Address):

Primary Contact: Peter J. Salvatore, Regulatory Coordinator, 1326 Strawberry Square, Harrisburg, PA 17120, (717) 787-4429

Secondary Contact:

(6) Primary Contact for Public Comments (List Telephone Number, Address, Fax Number and Email Address) – Complete if different from #5:

(All Comments will appear on IRRC'S website)

(7) Type of Rulemaking (check applicable box):

- Proposed Regulation
- Final Regulation
- Final Omitted Regulation
- Emergency Certification Regulation;
 - Certification by the Governor
 - Certification by the Attorney General

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(8) Briefly explain the regulation in clear and nontechnical language. (100 words or less)

The purpose of the proposed rulemaking is to update Chapter 147, commonly referred to as the "CPA Audit Rule." Chapter 147 was initially adopted in 1979 and requires insurers to have annual audits of their year-end statutory financial statements performed by independent certified public accountants (CPAs). The proposed rulemaking includes amendments made by the National Association of Insurance Commissioners ("NAIC") to Model Regulation 205, entitled "Annual Financial Reporting Model Regulation." Model Regulation 205 was developed as a result of the NAIC's review of The Sarbanes-Oxley Act of 2002, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 or SOX, and includes provisions related to auditor independence, corporate governance and internal control over financial reporting. These changes are expected to be required for the Insurance Department to maintain accreditation by the NAIC beginning in 2010.

(9) Include a schedule for review of the regulation including:

- | | |
|---|------------------------|
| A. The date by which the agency must receive public comments: | <u>March 16, 2009</u> |
| B. The date or dates on which public meetings or hearings will be held: | <u>N/A</u> |
| C. The expected date of promulgation of the proposed regulation as a final-form regulation: | <u>June 10, 2009</u> |
| D. The expected effective date of the final-form regulation: | <u>January 1, 2010</u> |
| E. The date by which compliance with the final-form regulation will be required: | <u>January 1, 2010</u> |
| F. The date by which required permits, licenses or other approvals must be obtained: | <u>N/A</u> |

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

The Department reviews each of its regulations for continued effectiveness on a triennial basis.

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SECTION II: STATEMENT OF NEED

(11) State the statutory authority for the regulation. Include specific statutory citation.

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.

(12) Is the regulation mandated by any federal or state law or court order, or federal regulation? Are there any relevant state or federal court decisions? If yes, cite the specific law, case or regulation as well as, any deadlines for action.

No. However, several of these changes will be required for the Insurance Department to maintain accreditation by the NAIC beginning in 2010.

(13) State why the regulation is needed. Explain the compelling public interest that justifies the regulation. Describe who will benefit from the regulation. Quantify the benefits as completely as possible and approximate the number of people who will benefit.

Since the proposed rulemaking concerns the solvency requirements applied to insurers, particularly regarding the reliability of the financial statements filed by insurers with the Insurance Department, the public will benefit to the extent the rulemaking promotes a financially sound insurance industry that has the ability to fulfill its contractual obligations under insurance policies.

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(14) If scientific data, studies, references are used to justify this regulation, please submit material with the regulatory package. Please provide full citation and/or links to internet source.

N/A

(15) Describe who and how many will be adversely affected by the regulation. How are they affected?

No adverse effects are anticipated as a result of this rulemaking. The rulemaking may impose auditor independence, corporate governance and internal control reporting requirements on insurers that are not currently subject to these standards. However, the rulemaking should have no adverse impact on these insurers, given the benefits of strong corporate governance and reliable financial reporting to their long-term financial stability. The rulemaking includes provisions for exemptions for smaller insurers and insurers already subject to similar requirements under Pennsylvania's insurance holding company laws or SEC requirements to avoid overly burdensome compliance costs.

(16) 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.

Insurance consumers of this Commonwealth will benefit from the rulemaking. The amendments to Chapter 147 will strengthen the reliability of insurer financial statements and promote strong corporate governance practices by insurers transacting business in Pennsylvania.

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SECTION III: COST AND IMPACT ANALYSIS

(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. Explain how the dollar estimates were derived.

The rulemaking may impose additional costs on insurers that are not currently subject to audit committee, auditor independence and internal control reporting requirements. The amount of the additional cost will depend on the type and extent of their existing processes and procedures for corporate governance and internal control over financial reporting. However, the strengthened requirements are consistent with national standards to be adopted by all states participating in the NAIC Financial Regulation Standards and Accreditation Program. In addition, the rulemaking minimizes costs by including a number of exemptions for smaller insurers and insurers already subject to similar requirements under insurance holding company and SEC laws and regulations.

(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. Explain how the dollar estimates were derived.

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. Explain how the dollar estimates were derived.

There are no material costs or savings to state government associated with this rulemaking.

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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) 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) Explain how the benefits of the regulation outweigh any cost and adverse effects.

The provisions relating to auditor independence, corporate governance and internal control over financial reporting being added to the regulation in this rulemaking were developed by federal and state regulators in response to a number of high-profile business failures, such as Enron and WorldCom, involving conflicts of interest and improper accounting. This rulemaking incorporates certain best practices from SOX identified by state insurance regulators as important to promote the accuracy and reliability of insurer financial statements. The rulemaking represents a reasonable, balanced proposal with long-term benefits to the integrity and financial soundness of the insurance industry that far outweigh any additional costs incurred by insurers to achieve compliance.

(22) Describe the communications with and input from the public and any advisory council/group in the development and drafting of the regulation. List the specific persons and/or groups who were involved.

Comments on this rulemaking were requested from The Insurance Federation of Pennsylvania, Inc., The Pennsylvania Association of Mutual Insurance Companies, the Pennsylvania Fraternal Congress, 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*.

(23) Include a description of any alternative regulatory provisions which have been considered and rejected and a statement that the least burdensome acceptable alternative has been selected.

No other regulatory schemes were considered. The amendment to Chapter 147 is necessary to revise the standards of the chapter in accordance with standards promulgated by the NAIC.

(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 regulations.

No.

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(25) How does this regulation compare with those of other states? How will this affect Pennsylvania's ability to compete with other states?

The rulemaking will not put Pennsylvania at a competitive disadvantage with other states. Adoption of the rulemaking is necessary for Pennsylvania to continue to meet national standards for the financial regulation of the insurance industry.

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

No.

(27) Submit a statement of legal, accounting or consulting procedures and additional reporting, recordkeeping or other paperwork, including copies of forms or reports, which will be required for implementation of the regulation and an explanation of measures which have been taken to minimize these requirements.

The rulemaking will impose additional costs on insurers that are not currently subject to internal control reporting requirements. The rulemaking minimizes these costs by including a number of exemptions or alternatives for smaller insurers and insurers already subject to similar requirements under insurance holding company and SEC laws and regulations. The rulemaking may reduce paperwork to the extent that it provides for the filing of documents in electronic form.

(28) 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 a number of exemptions or alternatives to meet the needs of smaller insurers.

CDL-1

FACE SHEET
FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE
BUREAU

(Pursuant to Commonwealth Documents Law)

DO NOT WRITE IN THIS SPACE

Copy below is hereby approved as to
form and legality. Attorney General

By

Angela Elliott

(Deputy Attorney General)

NOV 10 2008

Date of Approval

→ 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. 11-238

DATE OF ADOPTION:

BY:

Joel Ario

Joel Ario
Insurance Commissioner

TITLE:
(EXECUTIVE OFFICER, CHAIRMAN OR
SECRETARY)

Copy below is hereby approved as to form and
legality. Executive or Independent Agencies

BY:

Andrew C. Clark

Andrew C. Clark

OCT 15 2008

DATE OF APPROVAL

(DEPUTY GENERAL COUNSEL)
(~~CHIEF COUNSEL, INDEPENDENT AGENCY~~)
(STRIKE INAPPLICABLE TITLE)

→ Check if applicable. No Attorney General
approval or objection within 30 days after
submission.

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 of the Department's regulations (31 Pa. Code Ch. 147) (relating to Annual Audited Insurers' Financial Report Required) to read as set forth in Annex A, 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 was initially adopted in 1979 and requires insurers to have annual audits of their year-end statutory financial statements performed by independent certified public accountants (CPAs). It is based on a model regulation developed by the National Association of Insurance Commissioners (NAIC) and included in the NAIC's Financial Regulation Standards and Accreditation Program.

The amendments in this rulemaking are consistent with a new version of the NAIC model adopted in 2006, entitled "Annual Financial Reporting Model Regulation" (Model Regulation 205). The revised NAIC model was developed as a result of the NAIC's review of The Sarbanes-Oxley Act of 2002, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 or the Sarbanes-Oxley Act of 2002, ("SOX"), and includes provisions related to auditor independence, corporate governance and internal control over financial reporting. The Department expects that the proposed amendments to Chapter 147 will be required for the Department to maintain accreditation by the NAIC beginning in 2010.

Explanation of Regulatory Requirements

The following is a description of the changes contained in the proposed rulemaking:

The heading of Chapter 147 is being updated to reflect the content of the regulation.

Section 147.1 (relating to purpose) and is being amended to reflect the additional financial reporting requirements related to audits included in this rulemaking.

Section 147.2 (relating to definitions) is being amended to: (1) reference definitions of terms used in the regulation as defined in the law relating to insurance holding companies; and (2) add definitions to clarify new terms relating to audit committee requirements, internal control over financial reporting and other SOX-related terms consistent with the revised NAIC model.

Subsection 147.3(a) (relating to filing and extensions for filing required reports and communications) is being amended to reference supplemental guidance published in the NAIC *Accounting Practices and Procedures Manual*, defined for purposes of this regulation as the "NAIC Implementation Guide." The Department is also proposing to amend the provisions in § 147.3(b) relating to requesting an extension of the June 1 annual filing date for audited financial reports by reducing the time period for extensions from 30 to 15 days. The reliability of annual financial statements filed by insurers with state regulators is crucial to the Department's solvency monitoring and financial regulation efforts. Reducing the time period for any extensions is based on the Department's experience in dealing with financially troubled insurers and is an important part of the Department's efforts over the past several years to promote the submission of timely filings and reduce a relatively high number of annual requests for extensions. Because of the inter-relationship of the various reports and communications required under the chapter, the amendments also clarify that an extension of the filing date for an audited financial report provides for an extension of the due dates for these other filings.

Section 147.3a (relating to requirements for audit committees) is being added consistent with the revised NAIC model to require domestic insurers subject to the regulation to establish audit committees. The section includes requirements relating to the qualifications and independence of audit committee members and audit committee responsibilities. These new requirements allow for the designation of an audit committee for one or more controlled insurers and include exemptions based on the amount of premiums written by an insurer, whether the insurer is subject to audit committee requirements under SOX or Pennsylvania laws relating to insurance holding company systems, and for continuing care providers.

Section 147.4 (relating to contents of annual audited financial report) is being amended to update terminology to reflect current financial reporting requirements. In addition, § 147.4 (b)(2) is being amended to provide the Commissioner with discretion in determining whether an insurer is required to file an amendment to its annual financial statement to reflect differences between that statement and the insurer's audited financial statement. The paragraph requires all difference to be disclosed and reconciled in the notes to the annual financial statements. This amendment would allow the Commissioner to determine whether the differences also require the filing of an amended statement.

Section 147.5 (relating to designation of independent certified public accountant) is being amended to clarify current requirements for notice provided to the Department relating to accountants retained by insurers to conduct the annual audits required under this chapter, particularly in instances where the accountant is replaced, dismissed or resigns.

Section 147.6 (relating to recognition, qualification and responsibilities of an independent certified public accountant) is being amended to include provisions from the revised NAIC model to avoid conflicts of interest in the engagement of accountants to conduct annual audits. The restrictions include situations where a current officer or director of an insurer was involved in an audit of the insurer during the year before the beginning of the current audit period and also specify what types of other services an accountant retained to conduct an audit may or may not provide to the insurer. In addition, § 147.6 (d) is being amended to shorten the consecutive time period that an accountant may be primarily responsible for an insurer's audit from seven to five years. Subsection 147.6 (h) provides for application for relief and exemptions from these restrictions based on unusual circumstances, financial or organizational hardship. The criteria for determining whether relief may be granted include the size or amount of business written by the insurer. The new requirements do not apply to continuing care providers.

The provisions currently found in § 147.15 (relating to letter of qualifications of independent certified public accountant) are being moved to new § 147.6a to follow the related section establishing the accountant's qualifications and responsibilities. This change will facilitate efforts to understand and comply with these requirements and is in response to past questions and comments the Department has received from users of the regulation. In addition, § 147.6a (3) is being amended to clarify that descriptions of auditing experience is required for only the key staff assigned by an accountant to work on an audit.

Section 147.8 (relating to scope of audit and report of independent certified public accountant) is being amended to incorporate current national auditing standards relating to internal controls over financial reporting.

Section 147.9a (relating to establishment and communication of internal control over financial reporting) is being added consistent with the revised NAIC model to require insurers to establish policies and procedures providing for internal control over financial reporting. The section lists the required elements or outcomes of policies and procedures for internal control over financial reporting and requires insurers to file a written communication prepared by the accountant retained to conduct the audit describing internal control related matters identified in the audit. The communication must state whether any unremediated material weaknesses in the insurer's internal control over financial reporting were identified in the audit and what actions have or will be taken to eliminate any unremediated material weaknesses.

Section 147.9b (relating to management's report of internal control over financial reporting) is also being added consistent with the revised NAIC model to require insurers to file an annual report of internal control over financial reporting prepared by the insurer's management, including an assertion, made to the best of management's knowledge and belief after diligent inquiry, as to whether the insurer's internal control is effective to provide reasonable assurance regarding the reliability of its annual financial statement filed with the Department. The section includes a premium threshold for automatic annual filings of the report and criteria for the Department's acceptance of an annual report on internal control over financial reporting and related attestation filed under SOX, defined in § 147.2 (relating to definitions) as a "Section 404 Report."

Section 147.10 (relating to report on significant deficiencies in internal controls) is being deleted as outdated since this report is being replaced by the new reporting requirements proposed in the amendments to this chapter.

Section 147.12 (relating to examinations) is also being deleted as outdated and unnecessary. The Department is implementing a new risk-focused approach to the conduct of financial examinations that includes a consideration of an insurer's internal controls over financial reporting. The Department believes a reference to its statutory authority under the laws and regulations related to the Department's conduct of on-site financial examinations is not needed for purposes of this regulation, which relates to annual audited financial reports filed by insurers with the Department.

Section 147.13 (relating to effective date and exemption) is being amended to establish a January 1, 2010 effective date for the final-form rulemaking amending the chapter and to update and clarify current exemptions.

Affected Parties

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

Fiscal Impact

State Government

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

General Public

The public will benefit to the extent the rulemaking strengthens financial solvency regulatory requirements for insurers, thereby promoting the ability of the insurance industry to meet obligations under insurance policies.

Political Subdivisions

The rulemaking will not impose additional costs on political subdivisions.

Private Sector

The rulemaking would impose additional costs on insurers that are not currently subject to audit committee and internal control reporting requirements. However, the strengthened requirements are consistent with national standards to be adopted by all states participating in the NAIC Financial Regulation Standards and Accreditation Program. The rulemaking minimizes costs by

including a number of exemptions for smaller insurers and insurers already subject to similar requirements under insurance holding company and SEC laws and regulations.

Paperwork

The rulemaking would not impose additional paperwork on the Department. The amendments would require insurers to file new reports relating to internal control over financial reporting; however, 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 January 1, 2010. 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) 705-3873.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P.S. §745.5(a)), on February 3, 2009, 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.

The 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.

Joel Ario
Insurance Commissioner

CONTINUING 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] ANNUAL FINANCIAL REPORTING REQUIREMENTS

147.1	Purpose.
147.2	Definitions.
147.3	Filing and extensions for filing [annual audited financial report] <u>required reports and communications.</u>
147.3a	<u>Requirements for audit committees.</u>
147.4	Contents of annual audited financial report.
147.5	Designation of independent certified public accountant.
147.6	[Qualifications of independent certified public accountant] <u>Recognition, qualification and responsibilities of an independent certified public accountant.</u>
147.6a	<u>Letter of qualifications of independent certified public accountant.</u>
147.6b	<u>Conduct of insurer relating to audits.</u>
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.
147.9a	<u>Establishment and communication of internal control over financial reporting.</u>
147.9b	<u>Management's report of internal control over financial reporting.</u>
147.10	[Report on significant deficiencies in internal controls.] <u>Reserved.</u>
147.11	Definitions, availability and maintenance of independent certified public accountant workpapers.
147.12	[Examinations.] <u>Reserved.</u>
147.13	Effective date and exemption.
147.14	Penalties.
147.15	[Letter of qualifications of independent certified public accountant.] <u>Reserved.</u>

§ 147.1. Purpose.

The purpose of this chapter is to improve the Department's surveillance [**for**] **of** the financial condition of insurers by requiring the filing of an annual audit by independent certified public accountants of the financial statements reporting the financial condition and the results of operations of insurers[.], **a written communication detailing internal control related matters**

noted in the audit, and a written report by management of internal control over financial reporting.

§ 147.2. Definitions.

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

Affiliate—As defined in § 1401 of The Insurance Company Law of 1921 (40 P.S. § 991.1401).

Assumed premiums—Total premiums assumed by an insurer from non-affiliated insurers.

Audit committee—A committee or equivalent body established by the board of directors or equivalent body of an insurer for the purpose of overseeing the accounting and financial reporting processes, audits of financial statements, and internal control structure of the insurer or insurer group. The term includes a committee established pursuant to the provisions of section 1405(c)(4) or (5) of The Insurance Company Law of 1921 (40 P.S. § 991.1405(c)(4),(5)).

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.

Control, controlling, controlled by and under common control with—As defined in § 1401 of The Insurance Company Law of 1921 (40 P.S. § 991.1401).

Department—The Insurance Department of the Commonwealth.

Direct written premiums -- Total premiums directly written by an insurer. *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 CPA 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 CPA Law or similar laws.

(ii) For 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 nonprofit health plan corporation, whether operating a hospital plan or a professional health services plan, or both.

(E) An employers' mutual liability insurance association.

(F) A health maintenance organization.

(G) A fraternal benefit society or beneficial association.

(H) 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 **under The Continuing Care Provider Registration and Disclosure Act (40 P.S. §§ 3201—3255)**.

Insurer group— Two or more affiliated insurers identified by a controlling entity for the purpose of evaluating the effectiveness of internal control over financial reporting.

Internal control over financial reporting -- The process effected by the board of directors, management and other personnel of an insurer or insurer group, which provides reasonable assurances regarding the reliability of the financial statements in accordance with § 147.9a (relating to establishment and communication of internal control over financial reporting).

NAIC—The National Association of Insurance Commissioners or successor organization.

NAIC Implementation Guide – The “Implementation Guide for the Annual Financial Reporting Model Regulation” published in the NAIC Accounting Practices and Procedures Manual, or successor publication, prescribed for financial reporting under

section 320(a)(2) of The Insurance Company Law of 1921 (40 P.S. § 443(a)(2)).

Person—As defined in § 1401 of The Insurance Company Law of 1921 (40 P.S. § 991.1401).

Sarbanes-Oxley Act--The Sarbanes-Oxley Act of 2002, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 (15 U.S.C.A. §§ 7201-7266).

Section 404 Report-- The annual report on internal control over financial reporting and the related attestation report of the independent certified public accountant filed pursuant to § 404 of the Sarbanes-Oxley Act (15 U.S.C.A. § 7262) and 17 CFR 229.308.

Securities Exchange Act—The Securities Exchange Act of 1934, as amended (15 U.S.C.A. §§ 78a et seq.).

Sarbanes-Oxley Act compliant entity--An entity that is either required to be or is voluntarily compliant with the following:

(i) The preapproval requirements of Section 201 of the Sarbanes-Oxley Act (15 U.S.C.A. § 78j-1).

(ii) The audit committee independence requirements of Section 301 of the Sarbanes-Oxley Act (15 U.S.C.A. § 78f).

(iii) The internal control over financial reporting requirements of § 404 of the Sarbanes-Oxley Act (15 U.S.C.A. § 7262) and 17 CFR 229.308.

Ultimate controlling person--A person which is not controlled by another person. An ultimate controlling person may be one or more of the following: individual, corporation, limited liability company, partnership, association, joint stock company, trust, unincorporated organization, or any similar entity or combination of the

foregoing who controls another person.

§ 147.3. Filing and extensions for filing [of annual audited financial report] required reports and communications.

(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 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.

Supplemental information related to reporting required under this chapter is published in the NAIC Implementation Guide.

(b) Extensions of the filing date may be granted by the Commissioner for ~~[30-day]~~**15-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. **A 15-day extension of the filing date granted by the Commissioner for an audited financial report shall provide for 15-day extensions of the filing dates for communication of internal control related matters noted in an audit under § 147.9a (relating to establishment and communication of internal control over financial reporting) and for management's report of internal control over**

financial reporting under § 147.9b (relating to management's report of internal control over financial reporting).

(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 as instructed by the Commissioner will be open to the public for examination and inspection.

§ 147.3a. Requirements for audit committees.

(a) Every insurer required to file an annual audited financial report under this chapter shall establish an audit committee.

(b) An ultimate controlling person may designate an audit committee of a controlling person to be the audit committee for one or more controlled insurers. The designation shall:

(1) Be in writing.

(2) Identify the ultimate controlling person.

(3) Explain the basis for the designation in sufficient detail for the Department to determine compliance with this chapter.

(4) Be provided by the ultimate controlling person or the insurer to the Department and the chief insurance regulatory official of each other state in which the controlled insurers are domiciled no later than April 1 of the year in which the insurer's audited financial report is required to be filed under this chapter.

(5) Be effective upon receipt by the Department and remain in effect unless and until modified or rescinded by subsequent notice provided by the ultimate controlling person or the insurer as required by paragraph (b)(4) of this section.

(c) Each member of the audit committee shall be a natural person who is either a member of the board of directors of the insurer or a member of the board of directors of a controlling person whose audit committee has been designated as the insurer's audit committee under paragraph (b).

(d) If an audit committee other than the entire board of directors of the insurer has not been established by the insurer or designated by an ultimate controlling person under paragraph (b), the insurer's entire board of directors shall constitute the audit committee.

(e) A proportion of an audit committee's members shall be independent in accordance with the following requirements:

(1) The proportion of audit committee members who shall be independent shall be calculated as follows:

(i) Where an insurer's direct written and assumed premiums are less than or equal to \$300,000,000 at the end of the most recent calendar year, 0% of the members are required to be independent.

(ii) Where an insurer's direct written and assumed premiums exceed \$300,000,000 but are not more than \$500,000,000 at the end of the most recent calendar year, at least 50% of members are required to be independent.

(iii) Where an insurer's direct written and assumed premiums exceed \$500,000,000 at the end of the most recent calendar year, at least 75% of members of the audit committee are required to be independent.

(2) If an audit committee of a controlling person has been designated to be the audit committee for one or more controlled insurers, the proportion of audit committee members who shall be independent shall be based on the insurer in the group with the greatest direct written and assumed premium.

(3) If an insurer's direct written and assumed premiums meet or exceed the direct written and assumed premiums threshold in paragraph (e)(1)(ii) or (iii) as of the end of a calendar year, the insurer shall comply with the required minimum proportion of independent audit committee members no later than January 1 following the next full calendar year, as described in the NAIC Implementation Guide.

(4) In order to be considered independent for purposes of this subsection, an audit committee member may not:

(i) Be an affiliate of the insurer.

(ii) Accept any consulting, advisory or other compensatory fee from the insurer or an affiliate of the insurer other than in the member's capacity as a member of the audit committee, board of directors or any other board committee.

(5) If an audit committee member ceases to be independent under this chapter, the person may remain an audit committee member until the earlier of the next annual meeting of the insurer or controlling person or one year from the occurrence of the event that caused the member to be no longer independent, if the insurer or ultimate controlling person provides the Department with written notice within 15 days of the occurrence of the event.

(f) The audit committee shall retain an independent certified public accountant to

conduct the annual audit and issue an audited financial report under this chapter in accordance with the following requirements:

(1) The audit committee shall be directly responsible for the appointment, compensation and oversight of the work of the independent certified public accountant and shall resolve disagreements between management and the independent certified public accountant relating to financial reporting for the purpose of preparing or issuing the audited financial report or related work under this chapter.

(2) The independent certified public accountant retained to conduct the annual audit under this chapter shall report directly to the audit committee. The audit committee shall require the independent certified public accountant to report to the audit committee in sufficient time to enable the committee to take appropriate action as required by Statement on Auditing Standards 114 (SAS 114), *The Auditor's Communication with Those Charged With Governance*, or successor publication and all of the following requirements:

(i) All significant accounting policies and material permitted practices.

(ii) All material alternative treatments of financial information within statutory accounting principles that have been discussed with the management of the insurer, ramifications of the use of alternative disclosures and treatments, and the treatment preferred by the independent certified public accountant.

(iii) Other material written communications between the independent certified public accountant and the management of the insurer, such as any management letter or schedule of unadjusted differences.

(3) The report required under paragraph (2) may be provided to the audit

committee on an aggregate basis for insurers in an insurer group, if the report identifies any substantial differences in reported items among the insurers in the group.

(g) Exemptions.

(1) The requirements of this section shall not apply to an insurer with direct written and assumed premiums less than \$500,000,000, excluding premiums reinsured with the Federal Crop Insurance Corporation and the Federal Flood Program, which has been granted an exemption by the Department on the basis of financial or organizational hardship under § 147.13(g).

(2) The requirements of this section do not apply to continuing care providers, foreign insurers, Sarbanes-Oxley compliant entities or direct or indirect wholly-owned subsidiaries of Sarbanes-Oxley compliant entities.

(3) The requirements of subsections (b), (c), (d) and (e) shall not apply to insurers subject to section 1405(c)(4) and (5) of The Insurance Company Law of 1921 (40 P.S. § 991.1405(c)(4) and (5)).

(h) This section shall not be interpreted to limit the Department's authority to require an insurer to take specific corrective action relating to the independence of audit committee members under sections 501—563, 501-A—515-A, and 501-B--515-B of The Insurance Department Act of 1921 (40 P.S. §§ 221.1—221.63, 221.1-A—221.15-A, and 221.1-B—221.15-B) (relating to suspension of business and risk-based capital requirements), 31 Pa. Code, Chapter 160 (relating to standards to define insurers deemed to be in hazardous financial condition) or other provisions of law.

§ 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]**Statement of** 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] Commissioner may require the insurer to** 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 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] communication of internal control related matters noted in the audit,** 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 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, **in accordance with the Department's instructions**, 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.

(1) 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.

(2) 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.

(3) Within 60 business days of submitting a notification of dismissal, resignation or replacement, the insurer shall 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 required under this chapter and shall obtain and file an awareness letter from the independent certified public accountants as required under subsection (b).

(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.] Recognition, qualification and responsibilities of an independent certified public accountant.

(a) An annual audited financial report must be prepared by a qualified independent certified public accountant recognized by the Commissioner.

[(a)](b) Except for insurers organized in Canada or the United Kingdom of Great Britain and Northern Ireland, [T]the Commissioner will not recognize a person or firm as a

qualified independent certified public accountant **nor accept an annual audited financial report prepared in whole or in part by the person or firm** 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.

(5) The person or firm employed a partner or senior manager who was involved in an audit of the insurer during the one year period preceding the date that the most current annual audited financial report is due and who currently serves as a member of the board of directors, president, chief executive officer, controller, chief financial officer, chief accounting officer, or in any equivalent position for the insurer.

(6) The person or firm provides to the insurer contemporaneously with the audit any of the following non-audit services:

(i) Bookkeeping or other services relating to the insurer's accounting records or financial statements.

(ii) Financial information systems design and implementation.

(iii) Appraisal or valuation services, fairness opinions or contribution-in-kind reports.

(iv) Actuarial advisory services.

(v) Internal audit outsourcing services.

(vi) Management functions or human resource services.

(vii) Broker or dealer, investment adviser or investment banking services.

(viii) Legal or expert services unrelated to the audit.

[(b)](c) 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 **nor accept an annual audited financial report repared in whole or in part by the person or firm** 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.

(3) The person or firm meets the criteria of paragraph (b)(5) or provides to the insurer contemporaneously with the audit any of the non-audit services prohibited under paragraph (b)(6) and the insurer has not been granted an exemption under subsection (h).

[(c) Except as otherwise provided in this section, the Commissioner will recognize an independent certified public accountant 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 CPA Law (63 P. S. §§ 9.1—9.16b) or similar laws.]

(d) [A]**The qualified independent certified public accountant’s lead** partner or other person [responsible for rendering an audited financial report]**primarily responsible for an insurer’s audit** may not act in that capacity for more than [7] **five** consecutive years. Following a [7-year] **five 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] **two** 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.]

(e) A qualified independent certified public accountant who performs an audit for an insurer may only engage in non-audit services, including tax services, for the insurer if all of the following requirements are met:

(1) The services are not prohibited under paragraph (b)(6).

(2) The independent certified public accountant does not function in the role of management, audit his or her own work or serve in an advocacy role for the insurer.

(3) The services have been approved in advance by the insurer's audit committee pursuant to subsection (f).

(f) All auditing and non-audit services provided to an insurer by the insurer's qualified independent certified public accountant shall be preapproved in writing by the insurer's audit committee, except that preapproval of non-audit services is not required if any of the following criteria are met:

(1) The insurer is a Sarbanes-Oxley compliant entity.

(2) The insurer is a direct or indirect wholly-owned subsidiary of a Sarbanes-Oxley compliant entity.

(3) The aggregate amount of the non-audit services constitute 5% or less of the total amount of fees paid or owed by the insurer to the qualified independent certified public accountant.

(g) An insurer's audit committee may delegate the authority to grant the preapprovals required under subsection (f) to one or more designated members of the audit committee.

A decision of any member to whom this authority is delegated shall be presented to the full audit committee at the next scheduled meeting.

(h) Applications for relief and exemptions.

(1) An insurer may apply to the Commissioner for relief from paragraph (b)(5) or subsection (d) or both on the basis of unusual circumstances. In determining whether relief should be granted, the Commissioner may consider the following factors:

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

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

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

(2) If relief is granted, the insurer shall include a copy of the granted relief with its audited financial report filed pursuant to § 147.3(a) (filing and extensions for filing required reports and communications).

(3) An insurer with direct written and assumed premium less than \$100,000,000 in a calendar year may apply for exemption from paragraph (b)(6) on the basis of financial or organizational hardship pursuant to § 147.13(g)(relating to effective date and exemption).

(4)The requirements of paragraphs (b)(5) and (6) and subsections (e), (f) and (g) do not apply to continuing care providers.

~~[(e)]~~ **(i)** 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.

~~[(f)]~~ **(i)** 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)]~~ **(k)** 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.

[(h)](l) 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.

[(i)](m) Within 60 days of receipt of notice from the Commissioner of a finding under subsection (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.

§ 147.6a. 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 of qualifications that includes all of the following:

- (1) A statement that the certified public accountant is independent from 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 general description of the independent certified public accountant's background and experience.

(3) A specific description of the insurer auditing experience of partners, senior managers, in-charge auditors or other key staff persons assigned to the engagement and a statement as to whether each staff person is an independent certified public accountant. This provision does not prohibit the independent certified public accountant from utilizing staff as the independent certified public accountant deems appropriate where consistent with the standards prescribed by generally accepted auditing standards.

(4) A statement that the independent certified public accountant understands that the annual audited financial report that 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.

(5) 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.

(6) A declaration 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.

(7) A declaration that the independent certified public accountant is in compliance with § 147.6 (relating to recognition, qualification and responsibilities of an independent certified public accountant).

§ 147.6b. Conduct of insurer relating to audits.

(a) When communicating with any accountant relating to an audit, review or communication required by this chapter, an officer or director of an insurer may not directly or indirectly:

(1) Make or cause to be made a materially false or misleading statement.

(2) Omit or cause another person to omit any material fact necessary in order to make statements made, in light of the circumstances under which the statements are made, not misleading.

(b) An officer or director of an insurer or any other person acting under the direction thereof, may not, directly or indirectly take any action to coerce, manipulate, mislead or fraudulently influence an accountant performing an audit under this chapter if he or she knows or should have known that the action, if successful, could render the insurer's financial statements materially misleading.

(c) For purposes of subsection (b), actions that could render an insurer's financial statements materially misleading include but are not limited to actions which would result in the accountant:

(1) Issuing or reissuing a report on an insurer's financial statements that materially violates statutory accounting principles prescribed by the Commissioner, generally

accepted auditing standards, or other professional or regulatory standards.

(2) Failing to perform an audit, review or other procedures required by generally accepted auditing standards or other professional standards.

(3) Failing to comply with § 147.9(d) (relating to notification of adverse financial condition).

(4) Failing to communicate matters to an insurer's audit committee.

(5) Violating any provision of this chapter.

§ 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) 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).

§ 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.

(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] NAIC. Consideration shall also be given to other procedures in the *Financial Condition Examiner's Handbook* adopted by the [National Association of Insurance Commissioners] NAIC. The independent certified public accountant shall obtain an understanding of internal control sufficient to plan the audit in accordance with AU Section 319 of the Professional Standards of the American Institute of Certified Public Accountants, *Consideration of Internal Control in a Financial Statement Audit* (AU 319). To the extent required by AU 319 and as part of the independent certified public accountant's professional requirements defined in Statement on Auditing Standards (SAS) No. 102, *Defining Professional Requirements in Statements on Auditing Standards* or its replacement,

the independent certified public accountant shall consider the most recently available Management's Report of Internal Control over Financial Reporting, as required under § 147.9b, in planning and performing the audit of an insurer's statutory financial statements.

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

(d) The Commissioner may 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 by **this chapter** to [furnish the] **file an** 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, 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 subsection (b).

(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.

§ 147.9a. Establishment and communication of internal control over financial reporting.

(a) An insurer or insurer group must establish internal control over financial reporting policies and procedures designed to provide reasonable assurance that:

(1) The financial statements of the insurer or insurer group as required under § 147.4(b) and (c) (relating to contents of annual audited financial report) are reliable.

(2) Records are created and maintained to accurately and fairly reflect dispositions of assets and other transactions.

(3) Transactions are recorded as needed to prepare financial statements.

(4) Receipts and expenditures are made only as authorized by the management or board of directors of the insurer or insurer group.

(5) Unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements of the insurer or insurer group are prevented or detected in a timely manner.

(b) An insurer required by this chapter to file an annual audited financial report shall provide the Department with a written communication prepared by the independent certified public accountant describing internal control related matters identified in the audit. The written communication shall be filed with the Department within 60 days after the filing of the annual audited financial report.

(c) The communication shall include a description of any unremediated material weakness in the insurer's internal control over financial reporting as of the immediately preceding December 31 or a statement that no unremediated material weaknesses were identified in the audit. For purposes of this subsection, the term "material weakness" is as defined by AU Section 325 of the Professional Standards of the American Institute of Certified Public Accountants, (SAS 112) *Communicating Internal Control Related Matters Identified in an Audit*, or its replacement.

(d) If a communication of internal control related matters filed under subsection (b) includes a description of unremediated material weaknesses, either the independent certified public accountant or the insurer shall provide the Department, within 60 days

after the filing of the annual audited financial report, a written description of actions taken or proposed to eliminate the unremediated material weaknesses.

§ 147.9b. Management's report of internal control over financial reporting.

(a) An insurer that is required to file an audited financial report and that has annual direct written and assumed premiums equal to or greater than \$500,000,000, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, shall file with the Department a management's report of internal control over financial reporting of the insurer or insurer group. A management's report of internal control over financial reporting shall be filed for an insurer group if the annual direct written and assumed premiums of any one insurer in the group is equal to or greater than \$500,000,000, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program. However, the Commissioner may require an insurer that has less than \$500,000,000 in annual direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, to file a management's report of internal control over financial reporting under sections 501—563, 501-A—515-A, and 501-B--515-B of The Insurance Department Act of 1921 (40 P.S. §§ 221.1—221.63, 221.1-A—221.15-A, and 221.1-B—221.15-B) (relating to suspension of business and risk-based capital requirements), 31 Pa. Code, Chapter 160 (relating to standards to define insurers deemed to be in hazardous financial condition) or other provisions of law. If an insurer previously not required to file a management's report of internal control over financial reporting because it did not meet the \$500,000,000 threshold is subsequently required to file the report because its premiums equal or exceed the threshold, the insurer or the insurer group shall have two (2) years following the year

the threshold is exceeded to file the report.

(b) The management's report of internal control over financial reporting shall be prepared by management as of the immediately preceding December 31, filed with the report of internal control related matters required under § 147.9a (relating to establishment and communication of internal control over financial reporting) and include:

(1) Statement that management is responsible for establishing and maintaining adequate internal control over financial reporting.

(2) Statement that management has established internal control over financial reporting.

(3) Brief description of the approach or processes by which management evaluated the effectiveness of its internal control over financial reporting.

(4) Disclosure of any unremediated material weaknesses in the internal control over financial reporting identified by management as of the immediately preceding December 31.

(5) Assertion to the best of management's knowledge and belief, after diligent inquiry, as to whether its internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles.

(A) Management may base its assertion, in part, upon its review, monitoring and testing of internal controls undertaken in the normal course of its activities.

(B) Management may not assert that internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles if one or more

unremediated material weaknesses in internal control over financial reporting are disclosed as required by paragraph (4).

(C) Management shall create and maintain documentation relating to the basis upon which its assertion in management's report of internal control over financial reporting is made. Management shall have discretion as to the nature and extent of documentation in order to make its assertion in a cost-effective manner, including assembly of or reference to existing documentation. The documentation shall be made available to Department examiners and given confidential treatment under the authority of sections 901—908 of The Insurance Department Act of 1921 (40 P.S. §§323.1—323.8).

(6) Statement regarding the inherent limitations of internal control systems.

(7) Signatures of chief executive officer and chief financial officer or individuals holding equivalent positions. A management's report of internal control over financial reporting filed for an insurer group shall include a statement identifying the officers or individuals in equivalent positions who have been authorized by management to sign the report on behalf of the affiliated insurers in the group.

(c) An insurer may satisfy the requirements of subsection (a) by filing a Section 404 report of the insurer or insurer group if:

(1) The insurer or insurer group is at least one of the following:

(A) Directly subject to Section 404.

(B) A Sarbanes-Oxley compliant entity not directly subject to Section 404.

(C) A member of a holding company system whose parent is directly subject to Section 404.

(D) A member of a holding company system whose parent is not directly subject to Section 404 and is a Sarbanes-Oxley compliant entity.

(2) The scope of the Section 404 report includes internal controls of the insurer or insurer group that have a material impact on the preparation of the audited statutory financial statements of the insurer or insurer group as required under § 147.4 (b) and (c) (relating to contents of annual audited financial report).

(3) The Section 404 report includes an addendum consisting of a positive statement by management that no material processes relating to the preparation of the audited statutory financial statements of the insurer or insurer group, as required under § 147.4 (b) and (c) (relating to contents of annual audited financial report) are excluded from the Section 404 report.

(d) An insurer or insurer group that satisfies the requirements of subparagraphs (c)(1) and (3) but the scope of its Section 404 report does not satisfy the requirements of subparagraph (c)(2) may satisfy the requirements of subsection (a) by filing one of the following:

(1) A management's report of internal control over financial reporting as required under subsection (b).

(2) A Section 404 report and a management's report of internal control over financial reporting for those internal controls that have a material impact on the preparation of the audited statutory financial statements of the insurer or insurer group and that are not included within the scope of the Section 404 report.

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

§ 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.

(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.] Reserved.

§ 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 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.] **Reserved.**

§ 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(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(d) shall become effective November 11, 1997.] Insurers shall comply with this chapter for annual audited financial reports beginning January 1, 2010.**

(c) Foreign 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) 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 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] are** 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 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 **all or part of** 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. **If an exemption is granted, the insurer shall file a copy of the exemption with the NAIC and as required by the chief insurance regulatory official in all states where the insurer is licensed or is doing business.** Within 10 days from a denial of the written [request] **application** 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) In the case of 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)**] **§ 147.6a (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 **required reports and communications**) 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).] Reserved.



February 3, 2009

Mr. Kim Kaufman
Executive Director
Independent Regulatory Review Comm.
333 Market Street
Harrisburg, PA 17101

Re: Insurance Department Proposed Regulation No. 11-238, Annual Audited Insurers' Financial Report Required

Dear Mr. Kaufman:

Pursuant to Section 5(a) of the Regulatory Review Act, enclosed for your information and review is proposed 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." Chapter 147 was initially adopted in 1979 and requires insurers to have annual audits of their year-end statutory financial statements performed by independent certified public accountants (CPAs). It is based on a model regulation developed by the National Association of Insurance Commissioners (NAIC) and included in the NAIC's Financial Regulation Standards and Accreditation Program.

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: 11-238
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

FILING OF REGULATION

DATE	SIGNATURE	DESIGNATION
2/3/09	<i>Shilo Caspart</i>	HOUSE COMMITTEE ON INSURANCE
2/3/09	<i>Rosemary</i>	MAJORITY CHAIRMAN <u>REP. ANTHONY DELUCA</u>
2/3/09	<i>Ky Miller</i>	SENATE COMMITTEE ON BANKING & INSURANCE
2/3/09	<i>J. Willard</i>	MAJORITY CHAIRMAN <u>SEN. DONALD C. WHITE</u>
2/3/09	<i>Kathy Cooper</i>	INDEPENDENT REGULATORY REVIEW COMMISSION
		ATTORNEY GENERAL
2/3/09	<i>Mayra Garcia</i>	LEGISLATIVE REFERENCE BUREAU