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2016 FEB 17 PM 3:44



February 17, 2016

Via E-Mail

Bridget Burke, Regulatory Coordinator  
Insurance Department  
Commonwealth of Pennsylvania  
1341 Strawberry Square  
Harrisburg, PA 17120

Re: Annual Financial Reporting Requirements 11-254 (IRRC #3129)

Dear Ms. Burke:

The Pennsylvania Institute of Certified Public Accountants (PICPA) is a professional association of more than 22,000 members working to improve the CPA profession and better serve the public interest. Founded in 1897, the PICPA is the second-oldest CPA organization in the United States. Membership includes practitioners in public accounting, education, government, and industry. We appreciate the opportunity to provide our input on the proposed Pennsylvania Insurance Department regulations 11-254 (IRRC #3129) relating to new internal auditing requirements. We support the proposed changes related to the internal auditor requirements. In connection with our review, we noted several additional points for enhancement and clarification. We understand that these changes may need to originate from the NAIC. Our comments are included below by section number.

**Section 2 – Definitions Accountant –** The requirement that the independent certified public accountants must be a member of the American Institute of Certified Public Accountants (AICPA) goes beyond the requirements for licensing purposes.

**Section 7 A – Qualifications of Independent Certified Public Accountant – (1) –** The requirement that the independent certified public accountants be in good standing with the AICPA goes beyond the requirements for licensing purposes.

**Section 3 J –** The definition of internal control uses outdated language and requires a conforming change to current guidance (AT501). Specifically, change “board of directors” to “those charged with governance.”

**Section 7 E (3) –** The requirement to reject an annual audited financial report from someone who “demonstrated a pattern or practice of failing to detect or disclose material information in

previous reports filed under the provisions of this regulation” is not clear. What constitutes “material information” that should be filed under the provisions of this regulation? Is “material information” a defined term? Where does the requirement to “detect material information” come from? Is this defined in the standards?

Section 9 – The regulations repeat verbiage from the AICPA professional standards that has been superceded. For example, the requirement to “obtain an understanding of internal control sufficient to plan the audit” is no longer consistent with the standards. The current standards at AU-C Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires the auditor to “obtain an understanding of internal control relevant to the audit.” The purpose of repeating the AICPA guidance in the regulations is unclear.

Section 9 – The meaning of the following sentence is unclear: “To the extent required by AU 319, for those insurers required to file a Management’s Report of Internal Control over Financial Reporting pursuant to Section 17, the independent certified public accountant should consider (as that term is defined in Statement on Auditing Standards (SAS) No. 102, *Defining Professional Requirements in Statements on Auditing Standards* or its replacement) the most recently available report in planning and performing the audit of the statutory financial statements.”

Section 12 C – Requires the accountant to issue a letter stating “that the accountant understands the annual audited financial report and his opinion thereon will be filed in compliance with this regulation and that the commissioner will be relying on this information in the monitoring and regulation of the financial position of insurers.” While the accountant should consider the nature of the filing, the scope of this statement extends beyond the parameters of the results of an audit performed in accordance with generally accepted auditing standards. Therefore, the accountant should not make this statement directly. Instead, the accountant will typically include a statement such as the statement noted below. We recommend including this language in the regulations so that accountants do not issue a letter with an improper statement.

While the accountant should understand that an objective of issuing a report on the statutory financial statements is to satisfy regulatory requirements, an audit is not planned to satisfy all objectives or responsibilities of insurance regulators. In this context, the Company and the insurance commissioners should understand that the objective of an audit of statutory financial statements in accordance with generally accepted auditing standards is to form an opinion and issue a report on whether the statutory financial statements present fairly, in all material respects, the admitted assets, liabilities, and capital and surplus, as well as the results of operations and cash flow in conformity with accounting practices prescribed or permitted by the Pennsylvania Insurance Department. Consequently, under generally accepted auditing standards, the accountant has the responsibility, within the inherent limitations of the auditing process, to plan and perform

the audit to obtain reasonable assurance about whether the statutory financial statements are free of material misstatement, whether caused by error or fraud, and to exercise due professional care in the conduct of the audit. The concept of selective testing of the data being audited, which involves judgment both as to the number of transactions to be audited and the areas to be tested, has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on financial statements. Audit procedures that are effective for detecting errors, if they exist, may be ineffective for detecting misstatement resulting from fraud. Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement resulting from fraud. In addition, an audit does not address the possibility that material misstatements caused by error or fraud may occur in the future. Also, the accountant's use of professional judgment and the assessment of materiality for the purpose of our audit means that matters may exist that would be assessed differently by insurance commissioners.

It is the responsibility of the management of the Company to adopt sound accounting policies, to maintain an adequate and effective system of accounts, and to establish and maintain an internal control that will, among other things, provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in conformity with accounting practices prescribed or permitted by the Pennsylvania Insurance Department.

The insurance commissioner should exercise due diligence to obtain whatever other information may be necessary for the purpose of monitoring and regulating the statutory financial position of insurers, and should not rely solely upon the independent auditor's report.

Section 14 G – Requires the accountant to communicate certain matters to the audit committee in accordance with SAS 61, *Communication with Audit Committee*. However, the wording does not conform to the standards, including the use of the terminology “material permitted practices,” “all material alternative treatments,” and “treatments preferred by the accountant.” The current requirements included with AICPA's generally accepted auditing standards are more comprehensive. Ultimately, the purpose of repeating the AICPA guidance into the regulations is unclear. If the guidance is retained, we recommend conforming it to the current AICPA guidance.

We also noted the following references included within the proposed regulations that have been superseded. As noted below, in some cases the regulations refer to the standards or a replacement standard.

- Section 9

- AU Section 319, *Consideration of Internal Control in a Financial Statement Audit*, is now AU-C Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. This guidance is included at Section 9 and does not include a reference to a replaced standard.
- SAS No. 102, *Defining Professional Requirements in Statements on Auditing Standards*, is now AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*. Reference included at Section 9 and does not refer to a replaced standard.
  
- Section 10 C - Section AU 561 of the professional standards of the AICPA is now AU-C Section 560, *Subsequent Events and Subsequently Discovered Facts*. This guidance is included at Section 10 C and does not include a reference to a replaced standard.
- Section 11 A - SAS 60, *Communication of Internal Control Related Matters Noted in an Audit*, is now AU-C Section 265, *Communicating Internal Control Related Matters Identified in an Audit*. This guidance is included at Section 11 A, but includes a reference to its replacement.
- Section 14 F - Reference to SAS 61, *Communication with Audit Committee*, is now AU-C Section 260, *The Auditor's Communication with Those Charged with Governance*. This guidance is included at Section 14 F, but includes a reference to its replacement.

We appreciate your consideration of our comments. We are available to discuss any of these comments with you at your convenience.

Sincerely,



Allison M. Henry, CPA, CGMA  
PICPA Staff Liaison, Not-For-Profit Committee

cc: Jodi A. Frantz, Insurance Department Counsel  
Independent Regulatory Review Commission