

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

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HOUSE BILL 1314
Senate Commerce Committee Substitute Adopted 6/15/09

Short Title: Annual Financial Reporting.-AB

(Public)

Sponsors:

Referred to:

April 9, 2009

1 A BILL TO BE ENTITLED
2 AN ACT TO IMPROVE THE INSURANCE COMMISSIONER'S ABILITY TO MONITOR
3 THE FINANCIAL CONDITION OF INSURERS.

4 The General Assembly of North Carolina enacts:

5 SECTION 1. Article 10 of Chapter 58 of the General Statutes is amended by
6 adding a new Part to read:

7 "Part 7. Annual Financial Reporting.

8 "§ 58-10-185. Purpose and scope.

9 (a) The purpose of this Part is to improve the Commissioner's ability to monitor the
10 financial condition of insurers by requiring (i) an annual audit of financial statements reporting
11 the financial position and the results of operations of insurers by independent certified public
12 accountants, (ii) communication of internal control related matters noted in an audit, and (iii)
13 management's report of internal control over financial reporting.

14 (b) Every insurer, as defined in G.S. 58-10-190, shall be subject to this Part. Insurers
15 having direct premiums written in this State of less than one million dollars (\$1,000,000) in any
16 calendar year and fewer than 1,000 policyholders or certificate holders of direct written policies
17 nationwide at the end of the calendar year shall be exempt from this Part for the year, unless the
18 Commissioner makes a specific finding that compliance is necessary for the Commissioner to
19 carry out statutory responsibilities, except that insurers having assumed premiums pursuant to
20 contracts of reinsurance of one million dollars (\$1,000,000) or more will not be exempt.

21 (c) Foreign or alien insurers filing the audited financial report in another state, pursuant
22 to that state's requirement for filing of audited financial reports, which has been found by the
23 Commissioner to be substantially similar to the requirements in this Part, are exempt from
24 G.S. 58-10-195 through G.S. 58-10-240 if:

25 (1) A copy of the audited financial report, communication of internal control
26 related matters noted in an audit, and the accountant's letter of qualifications
27 that are filed with the other state are filed with the Commissioner in
28 accordance with the filing dates specified in G.S. 58-10-195, 58-10-230, and
29 58-10-235, respectively. Canadian insurers may submit accountants' reports
30 as filed with the Office of the Superintendent of Financial Institutions,
31 Canada.

32 (2) A copy of any notification of adverse financial condition report filed with
33 the other state is filed with the Commissioner within the time specified in
34 G.S. 58-10-225.

35 (d) Foreign or alien insurers required to file management's report of internal control
36 over financial reporting in another state are exempt from filing the report in this State provided



1 the other state has substantially similar reporting requirements and the report is filed with the
2 Commissioner of the other state within the time specified.

3 (e) This Part shall not prohibit, preclude, or in any way limit the Commissioner from
4 ordering, conducting, or performing examinations of insurers in accordance with G.S. 58-2-131
5 through G.S. 58-2-134, known as the Examination Law.

6 **§ 58-10-190. Definitions.**

7 As used in this Part:

- 8 (1) "Accountant" or "independent certified public accountant" means an
9 independent certified public accountant or accounting firm in good standing
10 with the American Institute of Certified Public Accountants (AICPA) and in
11 all states in which he or she is licensed to practice; for Canadian and British
12 companies, it means a Canadian-chartered or British-chartered accountant.
- 13 (2) An "affiliate" of, or person "affiliated" with, a specific person has the same
14 meaning set forth in G.S. 58-19-5.
- 15 (3) "Audit committee" means a committee, or equivalent body, established by
16 the board of directors of an entity for the purpose of overseeing the
17 accounting and financial reporting processes of an insurer or group of
18 insurers and audits of financial statements of the insurer or group of insurers.
19 The audit committee of any entity that controls a group of insurers may be
20 deemed to be the audit committee for one or more of these controlled
21 insurers at the election of the controlling person as provided in
22 G.S. 58-10-245(f). If an audit committee is not designated by the insurer, the
23 insurer's entire board of directors shall constitute the audit committee.
- 24 (4) "Audited financial report" means and includes those items specified in
25 G.S. 58-10-200.
- 26 (5) "Controlling person" has the same meaning set forth in G.S. 58-19-5.
- 27 (6) "Group of insurers" means those licensed insurers included in the reporting
28 requirements of Article 19 of this Chapter, or a set of insurers as identified
29 by management, for the purpose of assessing the effectiveness of internal
30 control over financial reporting.
- 31 (7) "Indemnification" means an agreement of indemnity or a release from
32 liability where the intent or effect is to shift or limit in any manner the
33 potential liability of the person or firm for failure to adhere to applicable
34 auditing or professional standards, whether or not resulting from other
35 known misrepresentations made by the insurer or its representatives.
- 36 (8) "Insurer" means any insurance entity as identified in Articles 7, 8, 11, 15, 17,
37 23, 24, 25, 26, 65, and 67 of this Chapter and regulated by the
38 Commissioner.
- 39 (9) "Internal control over financial reporting" means a process effected by an
40 entity's board of directors, management, and other personnel designed to
41 provide reasonable assurance regarding the reliability of the financial
42 statements, that is, those items specified in G.S. 58-10-200(b)(2) through
43 G.S. 58-10-200(b)(6) and includes those policies and procedures that meet
44 all of the following criteria:
- 45 a. Pertain to the maintenance of records that, in reasonable detail,
46 accurately and fairly reflect the transactions and dispositions of
47 assets.
- 48 b. Provide reasonable assurance that transactions are recorded as
49 necessary to permit preparation of the financial statements, that is,
50 those items specified in G.S. 58-10-200(b)(2) through
51 G.S. 58-10-200(b)(6) and that receipts and expenditures are being

1 made only in accordance with authorizations of management and
2 directors.

3 c. Provide reasonable assurance regarding prevention or timely
4 detection of unauthorized acquisition, use, or disposition of assets
5 that could have a material effect on the financial statements,
6 including those items specified in G.S. 58-10-200(b)(2) through
7 G.S. 58-10-200(b)(6).

8 (10) "SEC" means the United States Securities and Exchange Commission, or
9 any successor agency.

10 (11) "Section 404" means Section 404 of the Sarbanes-Oxley Act of 2002 and the
11 SEC's rules and regulations promulgated under that act.

12 (12) "Section 404 report" means management's report on "internal control over
13 financial reporting" as defined by the SEC and the related attestation report
14 of the independent certified public accountant as described in Section 3A of
15 the Sarbanes-Oxley Act of 2002.

16 (13) "SOX-compliant entity" means an entity that either is required to be
17 compliant with, or voluntarily is compliant with, all of the following
18 provisions of the Sarbanes-Oxley Act of 2002: (i) Section 202. Preapproval
19 requirements of Title II, Auditor Independence; (ii) Section 301. Audit
20 Committees independence requirements of Title III, Corporate
21 Responsibility; and (iii) Section 404. Management assessment of internal
22 controls requirements of Title IV, Enhanced Financial Disclosures.

23 **"§ 58-10-195. General requirements related to filing and extensions for filing of annual**
24 **audited financial reports and audit committee appointment.**

25 (a) All insurers shall have an annual audit by an independent certified public accountant
26 and shall file an audited financial report with the Commissioner on or before June 1 for the year
27 ended December 31 immediately preceding. The Commissioner may require an insurer to file
28 an audited financial report earlier than June 1 with 90 days' advance notice to the insurer.

29 (b) Extensions of the June 1 filing date may be granted by the Commissioner for 30-day
30 periods upon a showing by the insurer and its independent certified public accountant of the
31 reasons for requesting an extension and determination by the Commissioner of good cause for
32 an extension. The request for extension must be received in writing not less than 10 days before
33 the due date and in sufficient detail to permit the Commissioner to make an informed decision
34 with respect to the requested extension.

35 (c) If an extension is granted in accordance with the provisions in subsection (b) of this
36 section, a similar extension of 30 days is granted to the filing of management's report of
37 internal control over financial reporting.

38 (d) Every insurer required to file an annual audited financial report pursuant to this Part
39 shall designate a group of individuals as constituting its audit committee, as defined in
40 G.S. 58-10-190. The audit committee of an entity that controls an insurer may be deemed to be
41 the insurer's audit committee at the election of the controlling person.

42 **"§ 58-10-200. Contents of annual audited financial report.**

43 (a) The annual audited financial report shall report the financial position of the insurer
44 as of the end of the most recent calendar year and the results of its operations, cash flows, and
45 changes in capital and surplus for the year then ended in conformity with G.S. 58-2-165(c). The
46 financial statements included in the audited financial report shall be prepared in a form and
47 using language and groupings substantially the same as the relevant sections of the annual
48 statement of the insurer filed with the Commissioner, and the financial statement shall be
49 comparative, presenting the amounts as of December 31 of the current year and the amounts as
50 of the immediately preceding December 31. However, in the first year in which an insurer is
51 required to file an audited financial report, the comparative data may be omitted.

1 (b) The annual audited financial report shall include the following:

2 (1) Report of independent certified public accountant.

3 (2) Balance sheet reporting admitted assets, liabilities, capital, and surplus.

4 (3) Statement of operations.

5 (4) Statement of cash flows.

6 (5) Statement of changes in capital and surplus.

7 (6) Notes to financial statements, which shall be those required by the
8 appropriate NAIC Annual Statement Instructions and the NAIC Accounting
9 Practices and Procedures Manual. The notes shall include a reconciliation of
10 differences, if any, between the audited statutory financial statements and the
11 annual statement filed pursuant to G.S. 58-2-165(c) with a written
12 description of the nature of these differences.

13 **"§ 58-10-205. Designation of independent certified public accountant.**

14 (a) Each insurer required by this Part to file an annual audited financial report must,
15 within 60 days after becoming subject to the requirement, register with the Commissioner in
16 writing the name and address of the independent certified public accountant or accounting firm
17 retained to conduct the annual audit. Insurers not retaining an independent certified public
18 accountant on the effective date of this Part shall register the name and address of their retained
19 independent certified public accountant not less than six months before the date when the first
20 audited financial report is to be filed.

21 (b) The insurer shall obtain a letter from the accountant and file a copy with the
22 Commissioner stating that the accountant is aware of the provisions of the insurance laws and
23 the regulations of the State of North Carolina that relate to accounting and financial matters and
24 affirming that the accountant will express his or her opinion on the financial statement in terms
25 of its conformity to the statutory accounting practices prescribed or otherwise permitted by the
26 Commissioner, specifying such exceptions as he or she may believe appropriate.

27 (c) If an accountant for the immediately preceding filed audited financial report is
28 dismissed or resigns, the insurer shall within five business days notify the Commissioner of this
29 event. The insurer shall also furnish the Commissioner with a separate letter within 10 business
30 days after the notification stating whether in the 24 months preceding such event there were
31 any disagreements with the former accountant on any matter of accounting principles or
32 practices, financial statement disclosure, or auditing scope or procedure; which disagreements,
33 if not resolved to the satisfaction of the former accountant, would have caused him or her to
34 make reference to the subject matter of the disagreement in connection with his or her opinion.
35 The disagreements required to be reported in response to this section include both those
36 resolved to the former accountant's satisfaction and those not resolved to the former
37 accountant's satisfaction. Disagreements contemplated by this section could include, but are not
38 limited to, disagreements between personnel of the insurer responsible for presentation of its
39 financial statements and personnel of the accounting firm responsible for rendering its report.
40 The insurer shall also in writing request the former accountant to furnish a letter addressed to
41 the insurer stating whether the accountant agrees with the statements contained in the insurer's
42 letter and, if not, stating the reasons for which he or she does not agree; and the insurer shall
43 furnish the responsive letter from the former accountant to the Commissioner together with its
44 own.

45 **"§ 58-10-210. Qualifications of independent certified public accountant.**

46 (a) The Commissioner shall not recognize a person or firm as a qualified independent
47 certified public accountant if the person or firm:

48 (1) Is not in good standing with the North Carolina State Board of Certified
49 Public Accountant Examiners and in all other states in which the accountant
50 is licensed to practice, or, for a Canadian or British company, that is not a
51 chartered accountant; or

1 (2) Has either directly or indirectly entered into an agreement of indemnity or
2 release from liability, collectively referred to as indemnification, with
3 respect to the audit of the insurer.

4 (b) Except as otherwise provided in this Part, the Commissioner shall recognize an
5 independent certified public accountant as qualified as long as he or she conforms to the
6 standards of his or her profession, as contained in the Code of Professional Ethics of the
7 AICPA and Rules and Regulations and Code of Ethics and Rules of Professional Conduct of
8 the North Carolina State Board of Certified Public Accountant Examiners or similar code.

9 (c) A qualified independent certified public accountant may enter into an agreement
10 with an insurer to have disputes relating to an audit resolved by mediation or arbitration.
11 However, in the event of a delinquency proceeding commenced against the insurer under
12 Article 30 of this Chapter, the mediation or arbitration provisions shall operate at the option of
13 the statutory successor.

14 (d) Lead Audit Partner Rotation Required.

15 (1) The lead or coordinating audit partner, having primary responsibility for the
16 audit, may not act in that capacity for more than five consecutive years. The
17 person shall be disqualified from acting in that or a similar capacity for the
18 same company or its insurance subsidiaries or affiliates for a period of five
19 consecutive years. An insurer may apply to the Commissioner for relief from
20 the rotation requirement on the basis of unusual circumstances. This
21 application shall be made at least 30 days before the end of the calendar
22 year. The Commissioner may consider any of the following factors in
23 determining if the relief should be granted:

24 a. The number of partners, expertise of the partners, or the number of
25 insurance clients in the currently registered firm.

26 b. The premium volume of the insurer.

27 c. The number of jurisdictions in which the insurer transacts business.

28 (2) The insurer shall file, with its annual statement filing, the approval for relief
29 granted pursuant to subdivision (1) of this subsection with the states in
30 which it is licensed or doing business and with the NAIC. If the nondomestic
31 state accepts electronic filing with the NAIC, the insurer shall file the
32 approval in an electronic format.

33 (e) The Commissioner shall neither recognize as a qualified independent certified
34 public accountant, nor accept an annual audited financial report prepared, in whole or in part,
35 by a natural person who meets any of the following criteria:

36 (1) The person has been convicted of fraud, bribery, a violation of the Racketeer
37 Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961 to 1968k, or
38 any dishonest conduct or practices under federal or state law.

39 (2) The person has been found to have violated the insurance laws of this State
40 with respect to any previous reports submitted under this Part.

41 (3) The person has demonstrated a pattern or practice of failing to detect or
42 disclose material information in previous reports filed under the provisions
43 of this Part.

44 (f) The Commissioner may, as provided in G.S. 58-2-50, hold a hearing to determine
45 whether an independent certified public accountant is qualified and, considering the evidence
46 presented, may rule that the accountant is not qualified for purposes of expressing his or her
47 opinion on the financial statements in the annual audited financial report made pursuant to this
48 Part and require the insurer to replace the accountant with another whose relationship with the
49 insurer is qualified within the meaning of this Part.

50 (g) Independence of Services.

- 1 (1) The Commissioner shall not recognize as a qualified independent certified
2 public accountant nor accept an annual audited financial report prepared, in
3 whole or in part, by an accountant who provides to an insurer,
4 contemporaneously with the audit, any of the following nonaudit services:
5 a. Bookkeeping or other services related to the accounting records or
6 financial statements of the insurer.
7 b. Financial information systems design and implementation.
8 c. Appraisal or valuation services, fairness opinions, or
9 contribution-in-kind reports.
10 d. Actuarially oriented advisory services involving the determination of
11 amounts recorded in the financial statements. The accountant may
12 assist an insurer in understanding the methods, assumptions, and
13 inputs used in the determination of amounts recorded in the financial
14 statement only if it is reasonable to conclude that the services
15 provided will not be subject to audit procedures during an audit of
16 the insurer's financial statements. An accountant's actuary may also
17 issue an actuarial opinion or certification on an insurer's reserves if
18 all of the following conditions have been met:
19 1. Neither the accountant nor the accountant's actuary has
20 performed any management functions or made any
21 management decisions.
22 2. The insurer has competent personnel, or engages a third-party
23 actuary to estimate the reserves for which management takes
24 responsibility.
25 3. The accountant's actuary tests the reasonableness of the
26 reserves after the insurer's management has determined the
27 amount of the reserves.
28 e. Internal audit outsourcing services.
29 f. Management functions or human resources.
30 g. Broker or dealer, investment adviser, or investment banking services.
31 h. Legal services or expert services unrelated to the audit.
32 i. Any other services that the Commissioner determines, by
33 administrative rule, are impermissible.

34 (2) In general, the principles of independence with respect to services provided
35 by the qualified independent certified public accountant are largely
36 predicated on three basic principles, violations of which would impair the
37 accountant's independence. The principles are that the accountant cannot
38 function in the role of management, cannot audit his or her own work, and
39 cannot serve in an advocacy role for the insurer.

40 (h) Insurers having direct written and assumed premiums of less than one hundred
41 million dollars (\$100,000,000) in any calendar year may request an exemption from
42 subdivision (1) of subsection (g) of this section. The insurer shall file with the Commissioner a
43 written statement discussing the reasons why the insurer should be exempt from these
44 provisions. If the Commissioner finds, upon review of this statement, that compliance with this
45 Part would constitute a financial or organizational hardship upon the insurer, an exemption may
46 be granted.

47 (i) A qualified independent certified public accountant who performs the audit may
48 engage in other nonaudit services, including tax services, that are not described in subdivision
49 (1) of subsection (g) of this section or that do not conflict with the principles set forth in
50 subdivision (2) of subsection (g) of this section, only if the activity is approved in advance by
51 the audit committee, in accordance with subsection (j) of this section.

1 (j) All auditing services and nonaudit services provided to an insurer by the qualified
2 independent certified public accountant of the insurer shall be preapproved by the audit
3 committee. The preapproval requirement is waived with respect to nonaudit services if the
4 insurer is a SOX-compliant entity or is a direct or indirect wholly owned subsidiary of a
5 SOX-compliant entity or all of the following apply:

6 (1) The aggregate amount of all such nonaudit services provided to the insurer
7 constitutes not more than five percent (5%) of the total amount of fees paid
8 by the insurer to its qualified independent certified public accountant during
9 the fiscal year in which the nonaudit services are provided.

10 (2) The services were not recognized by the insurer at the time of the
11 engagement to be nonaudit services.

12 (3) The services are promptly brought to the attention of the audit committee
13 and approved before the completion of the audit by the audit committee or
14 by one or more members of the audit committee who are the members of the
15 board of directors to whom authority to grant such approvals has been
16 delegated by the audit committee.

17 (k) The audit committee may delegate to one or more designated members of the audit
18 committee the authority to grant the preapprovals required by subsection (j) of this section. The
19 decisions of any member to whom this authority is delegated shall be presented to the full audit
20 committee at each of its scheduled meetings.

21 (l) Cooling-Off Period.

22 (1) The Commissioner shall not recognize an independent certified public
23 accountant as qualified for a particular insurer if a member of the board,
24 president, chief executive officer, controller, chief financial officer, chief
25 accounting officer, or any person serving in an equivalent position for that
26 insurer was employed by the independent certified public accountant and
27 participated in the audit of that insurer during the one-year period preceding
28 the date that the most current statutory opinion is due. This section shall only
29 apply to partners and senior managers involved in the audit. An insurer may
30 apply to the Commissioner for relief from this requirement on the basis of
31 unusual circumstances.

32 (2) The insurer shall file, with its annual statement filing, the approval for relief
33 granted pursuant to subdivision (1) of this subsection with the states in
34 which it is licensed or doing business and the NAIC. If the nondomestic state
35 accepts electronic filing with the NAIC, the insurer shall file the approval in
36 an electronic format.

37 **"§ 58-10-215. Consolidated or combined audits.**

38 An insurer may make written application to the Commissioner for approval to file audited
39 consolidated or combined financial statements in lieu of separate annual audited financial
40 statements if the insurer is part of a group of insurance companies that utilizes a pooling or one
41 hundred percent (100%) reinsurance agreement that affects the solvency of the insurer and
42 affects the integrity of the insurer's reserves and the insurer cedes all of its direct and assumed
43 business to the pool. In such cases, a columnar consolidating or combining worksheet that
44 meets all of the following criteria shall be filed with the report:

45 (1) Amounts shown on the consolidated or combined audited financial report
46 shall be shown on the worksheet.

47 (2) Amounts for each insurer subject to this section shall be stated separately.

48 (3) Noninsurance operations may be shown on the worksheet on a combined or
49 individual basis.

50 (4) Explanations of consolidating and eliminating entries shall be included.

1 (5) A reconciliation shall be included of any differences between the amounts
2 shown in the individual insurer columns of the worksheet and comparable
3 amounts shown on the annual statements of the insurers.

4 **"§ 58-10-220. Scope of audit and report of independent certified public accountant.**

5 Financial statements furnished pursuant to G.S. 58-10-200 shall be examined by the
6 independent certified public accountant. The audit of the insurer's financial statements shall be
7 conducted in accordance with generally accepted auditing standards. In accordance with AU
8 Section 319 of the Professional Standards of the AICPA, Consideration of Internal Control in a
9 Financial Statement Audit, the independent certified public accountant should obtain an
10 understanding of internal control sufficient to plan the audit. To the extent required by AU
11 Section 319, for those insurers required to file a management's report of internal control over
12 financial reporting pursuant to G.S. 58-10-255, the independent certified public accountant
13 should consider, as that term is defined in "Statement on Auditing Standards No. 102 of the
14 AICPA Professional Standards, Defining Professional Requirements in Statements on Auditing
15 Standards" or its replacement, the most recently available report in planning and performing the
16 audit of the statutory financial statements. Consideration shall be given to the procedures
17 illustrated in the Financial Condition Examiners Handbook promulgated by the NAIC as the
18 independent certified public accountant deems necessary.

19 **"§ 58-10-225. Notification of adverse financial condition.**

20 (a) The insurer required to furnish the annual audited financial report shall require the
21 independent certified public accountant to report, in writing, within five business days to the
22 board of directors or its audit committee any determination by the independent certified public
23 accountant that the insurer has materially misstated its financial condition as reported to the
24 Commissioner as of the balance sheet date currently under audit or that the insurer does not
25 meet the minimum capital and surplus requirement of G.S. 58-7-75 as of that date. An insurer
26 that has received a report pursuant to this subsection shall forward a copy of the report to the
27 Commissioner within five business days after receipt of the report and shall provide the
28 independent certified public accountant making the report with evidence of the report being
29 furnished to the Commissioner. If the independent certified public accountant fails to receive
30 the evidence within the required five-business-day period, the independent certified public
31 accountant shall furnish to the Commissioner a copy of its report within the next five business
32 days.

33 (b) No independent certified public accountant shall be liable in any manner to any
34 person for any statement made in connection with subsection (a) of this section if the statement
35 is made in good faith in compliance with that subsection.

36 (c) If the accountant, subsequent to the date of the audited financial report filed
37 pursuant to this Part, becomes aware of facts that might have affected his or her report, the
38 Commissioner notes the obligation of the accountant to take such action as prescribed in
39 Volume 1, Section AU 561 of the Professional Standards of the AICPA.

40 **"§ 58-10-230. Communication of internal control related matters noted in an audit.**

41 (a) In addition to the annual audited financial report, each insurer shall furnish the
42 Commissioner with a written communication as to any unremediated material weaknesses in its
43 internal control over financial reporting noted during the audit. Such communication shall be
44 prepared by the accountant within 60 days after the filing of the annual audited financial report
45 and shall contain a description of any unremediated material weakness, as the term "material
46 weakness" is defined by "Statement on Auditing Standards No. 112 of the AICPA Professional
47 Standards, Communication of Internal Control Related Matters Noted in an Audit," or its
48 replacement, as of December 31 immediately preceding, so as to coincide with the audited
49 financial report described in G.S. 58-10-195(a) in the insurer's internal control over financial
50 reporting noted by the accountant during the course of their audit of the financial statements. If
51 no unremediated material weaknesses are noted, the communication should so state.

1 (b) The insurer shall provide a description of remedial actions taken or proposed to
2 correct unremediated material weaknesses, if the actions are not described in the accountant's
3 communication.

4 **"§ 58-10-235. Accountant's letter of qualifications.**

5 The accountant shall furnish the insurer, in connection with, and for inclusion in, the filing
6 of the annual audited financial report, a letter stating all of the following:

- 7 (1) That the accountant is independent with respect to the insurer and conforms
8 to the standards of his or her profession as contained in the Code of
9 Professional Ethics and pronouncements of the AICPA and the Rules of
10 Professional Conduct of the North Carolina State Board of Certified Public
11 Accountant Examiners Board of Public Accountancy, or similar code.
- 12 (2) The background and experience in general and the experience in audits of
13 insurers of the staff assigned to the engagement and whether each is an
14 independent certified public accountant. Nothing within this Part shall be
15 construed as prohibiting the accountant from utilizing such staff as he or she
16 deems appropriate where their use is consistent with the standards prescribed
17 by generally accepted auditing standards.
- 18 (3) That the accountant understands the annual audited financial report and his
19 opinion thereon will be filed in compliance with this Part and that the
20 Commissioner will be relying on this information in the monitoring and
21 regulation of the financial position of insurers.
- 22 (4) That the accountant consents to the requirements of G.S. 58-10-240 and that
23 the accountant consents and agrees to make available for review by the
24 Commissioner, or the Commissioner's designee or appointed agent, the work
25 papers, as described in G.S. 58-10-240.
- 26 (5) A representation that the accountant is properly licensed by an appropriate
27 state licensing authority and is a member in good standing in the AICPA.
- 28 (6) A representation that the accountant is in compliance with the requirements
29 of G.S. 58-10-210.

30 **"§ 58-10-240. Definition, availability, and maintenance of independent certified public**
31 **accountants' work papers.**

32 (a) Work papers are the records kept by the independent certified public accountant of
33 the procedures followed, the tests performed, the information obtained, and the conclusions
34 reached pertinent to the accountant's audit of the financial statements of an insurer. Work
35 papers, accordingly, may include audit planning documentation, work programs, analyses,
36 memoranda, letters of confirmation and representation, abstracts of company documents, and
37 schedules or commentaries prepared or obtained by the independent certified public accountant
38 in the course of his or her audit of the financial statements of an insurer and which support the
39 accountant's opinion.

40 (b) Every insurer required to file an audited financial report pursuant to this Part shall
41 require the accountant to make available for review by the Commissioner all work papers
42 prepared in the conduct of the accountant's audit and any communications related to the audit
43 between the accountant and the insurer at the offices of the insurer, at the offices of the
44 Commissioner, or at any other reasonable place designated by the Commissioner. The insurer
45 shall require that the accountant retain the audit work papers and communications until the
46 Commissioner has filed a report on examination covering the period of the audit but no longer
47 than seven years after the date of the audit report.

48 (c) In the conduct of the periodic review by the Commissioner's examiners in
49 subsection (b) of this section, copies of pertinent audit work papers may be made and retained
50 by the Commissioner. Such reviews by the Commissioner's examiners shall be considered

1 investigations, and all working papers and communications obtained during the course of such
2 investigations shall be confidential.

3 **"§ 58-10-245. Requirements for audit committees.**

4 (a) This section shall not apply to foreign or alien insurers licensed in this State or an
5 insurer that is a SOX-compliant entity or a direct or indirect wholly owned subsidiary of a
6 SOX-compliant entity.

7 (b) The audit committee shall be directly responsible for the appointment,
8 compensation, and oversight of the work of any accountant, including resolution of
9 disagreements between management and the accountant regarding financial reporting, for the
10 purpose of preparing or issuing the audited financial report or related work. Each accountant
11 shall report directly to the audit committee.

12 (c) Each member of the audit committee shall be a member of the board of directors of
13 the insurer or a member of the board of directors of an entity elected pursuant to subsection (f)
14 of this section and G.S. 58-10-190(3).

15 (d) In order to be considered independent for purposes of this section, a member of the
16 audit committee shall not, other than in his or her capacity as a member of the audit committee,
17 the board of directors, or any other board committee, accept any consulting, advisory, or other
18 compensatory fee from the entity or be an affiliated person of the entity or any subsidiary of the
19 entity. However, if North Carolina law requires board participation by otherwise
20 nonindependent members, that law shall prevail and such members may participate in the audit
21 committee and be designated as independent for audit committee purposes, unless they are an
22 officer or employee of the insurer or one of its affiliates.

23 (e) If a member of the audit committee ceases to be independent for reasons outside the
24 member's reasonable control, that person, with notice by the responsible entity to the
25 Commissioner, may remain an audit committee member of the responsible entity until the
26 earlier of the next annual meeting of the responsible entity or one year from the occurrence of
27 the event that caused the member to be no longer independent.

28 (f) To exercise the election of the controlling person to designate the audit committee,
29 the ultimate controlling person shall provide written notice of the affected insurers to the
30 Commissioner. Notification shall be made timely before the issuance of the statutory audit
31 report and include a description of the basis for the election. The election can be changed
32 through notice to the Commissioner by the insurer, which shall include a description of the
33 basis for the change. The election shall remain in effect for perpetuity, until rescinded.

34 (g) Reports From Accountant.

35 (1) The audit committee shall require the accountant that performs for an insurer
36 any audit required by this Part to timely report to the audit committee in
37 accordance with the requirements of "Statement on Auditing Standards No.
38 61 of the AICPA Professional Standards, Communication with Audit
39 Committees," or its replacement, including all of the following:

- 40 a. All significant accounting policies and material permitted practices.
41 b. All material alternative treatments of financial information within
42 statutory accounting principles that have been discussed with
43 management officials of the insurer, ramifications of the use of the
44 alternative disclosures and treatments, and the treatment preferred by
45 the accountant.
46 c. Other material written communications between the accountant and
47 the management of the insurer, such as any management letter or
48 schedule of unadjusted differences.

49 (2) If an insurer is a member of an insurance holding company system, the
50 reports required by subdivision (1) of subsection (g) of this section may be
51 provided to the audit committee on an aggregate basis for insurers in the

holding company system, provided that any substantial differences among insurers in the system are identified to the audit committee.

(h) The proportion of independent audit committee members shall meet or exceed the following criteria:

<u>Prior Calendar Year Direct Written and Assumed Premiums</u>		
<u>\$0 – \$300,000,000</u>	<u>Over \$300,000,000 – \$500,000,000</u>	<u>Over \$500,000,000</u>
<u>No minimum requirements.</u>	<u>Majority (50% or more) of members shall be independent.</u>	<u>Supermajority of members (75% or more) shall be independent.</u>

The Commissioner shall require the entity's board to enact improvements to the independence of the audit committee membership if the insurer is in a risk-based capital action level event, meets one or more of the standards of an insurer deemed to be in hazardous financial condition, or otherwise exhibits qualities of a troubled insurer. The Commissioner may order any insurer with less than five hundred million dollars (\$500,000,000) in prior year direct written and assumed premiums to structure its audit committee with at least a supermajority of independent audit committee members. Prior calendar year direct written and assumed premiums shall be the combined total of direct premiums and assumed premiums from nonaffiliates for the reporting entities.

(i) An insurer with direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of less than five hundred million dollars (\$500,000,000) may apply to the Commissioner for a waiver from the requirements in this section based upon hardship. The insurer shall file, with its annual statement filing, the approval for relief from this section with the states in which it is licensed or doing business and with the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format.

"§ 58-10-250. Conduct of insurer in connection with the preparation of required reports and documents.

(a) No director or officer of an insurer shall, directly or indirectly, do any of the following:

- (1) Make or cause to be made a materially false or misleading statement to an accountant in connection with any audit, review, or communication required under this Part.
- (2) Omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which the statements were made, not misleading to an accountant in connection with any audit, review, or communication required under this Part.

(b) No officer or director of an insurer, or any other person acting under the direction thereof, shall directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence any accountant engaged in the performance of an audit pursuant to this Part if that person knew or should have known that the action, if successful, could result in rendering the insurer's financial statements materially misleading.

(c) For purposes of subsection (b) of this section, actions that, "if successful, could result in rendering the insurer's financial statements materially misleading" include, but are not limited to, actions taken at anytime with respect to the professional engagement period to coerce, manipulate, mislead, or fraudulently influence an accountant to do any of the following:

- (1) Issue or reissue a report on an insurer's financial statements that is not warranted in the circumstances, due to material violations of statutory

1 accounting principles prescribed by the Commissioner, generally accepted
2 auditing standards, or other professional or regulatory standards.

3 (2) Not perform audit, review, or other procedures required by generally
4 accepted auditing standards or other professional standards.

5 (3) Not withdraw an issued report.

6 (4) Not communicate matters to an insurer's audit committee.

7 **"§ 58-10-255. Management's report of internal control over financial reporting.**

8 (a) Every insurer required to file an audited financial report pursuant to this Part that
9 has annual direct written and assumed premiums, excluding premiums reinsured with the
10 Federal Crop Insurance Corporation and Federal Flood Program, of five hundred million
11 dollars (\$500,000,000) or more shall prepare a report of the insurer's or group of insurers'
12 internal control over financial reporting, as these terms are defined in G.S. 58-10-190. The
13 report shall be filed with the Commissioner along with the communication of internal control
14 related matters noted in an audit described under G.S. 58-10-230. Management's report of
15 internal control over financial reporting shall be as of December 31 immediately preceding.

16 (b) Notwithstanding the premium threshold in subsection (a) of this section, the
17 Commissioner may require an insurer to file management's report of internal control over
18 financial reporting if the insurer is in any risk-based capital level event, or meets any one or
19 more of the standards of an insurer deemed to be in hazardous financial condition as defined in
20 G.S. 58-30-60(b).

21 (c) An insurer or a group of insurers that is:

22 (1) Directly subject to Section 404;

23 (2) Part of a holding company system whose parent is directly subject to Section
24 404;

25 (3) Not directly subject to Section 404 but is a SOX-compliant entity; or

26 (4) A member of a holding company system whose parent is not directly subject
27 to Section 404 but is a SOX-compliant entity

28 may file its or its parent's Section 404 report and an addendum in satisfaction of this
29 subsection's requirement provided that those internal controls of the insurer or group of insurers
30 having a material impact on the preparation of the insurer's or group of insurers' audited
31 statutory financial statements for items included in G.S. 58-10-200(b)(2) through
32 G.S. 58-10-200(b)(6) were included in the scope of the Section 404 report. The addendum shall
33 be a positive statement by management that there are no material processes with respect to the
34 preparation of the insurer's or group of insurers' audited statutory financial statements for items
35 included in G.S. 58-10-200(b)(2) through G.S. 58-10-200(b)(6) that were excluded from the
36 Section 404 report. If there are internal controls of the insurer or group of insurers that have a
37 material impact on the preparation of the insurer's or group of insurers' audited statutory
38 financial statements and those internal controls were not included in the scope of the Section
39 404 report, the insurer or group of insurers may either file (i) a G.S. 58-10-255 report, or (ii) the
40 Section 404 report and a G.S. 58-10-255 report for those internal controls that have a material
41 impact on the preparation of the insurer's or group of insurers' audited statutory financial
42 statements not covered by the Section 404 report.

43 (d) Management's report of internal control over financial reporting shall include all of
44 the following:

45 (1) A statement that management is responsible for establishing and maintaining
46 adequate internal control over financial reporting.

47 (2) A statement that management has established internal control over financial
48 reporting and an assertion, to the best of management's knowledge and
49 belief, after diligent inquiry, as to whether its internal control over financial
50 reporting is effective to provide reasonable assurance regarding the

1 reliability of financial statements in accordance with statutory accounting
2 principles.

3 (3) A statement that briefly describes the approach or processes by which
4 management evaluated the effectiveness of its internal control over financial
5 reporting.

6 (4) A statement that briefly describes the scope of work that is included and
7 whether any internal controls were excluded.

8 (5) Disclosure of any unremediated material weaknesses in the internal control
9 over financial reporting identified by management as of December 31
10 immediately preceding. Management is not permitted to conclude that the
11 internal control over financial reporting is effective to provide reasonable
12 assurance regarding the reliability of financial statements in accordance with
13 statutory accounting principles if there are one or more unremediated
14 material weaknesses in its internal control over financial reporting.

15 (6) A statement regarding the inherent limitations of internal control systems.

16 (7) Signatures of the chief executive officer and the chief financial officer, or
17 equivalent position/title.

18 (e) Management shall document and make available upon a financial condition
19 examination the basis upon which its assertions, required in subsection (d) of this section, are
20 made. Management may base its assertions, in part, upon its review, monitoring, and testing of
21 internal controls undertaken in the normal course of its activities. Management shall have
22 discretion as to the nature of the internal control framework used, and the nature and extent of
23 documentation, in order to make its assertion in a cost-effective manner and, as such, may
24 include assembly of or reference to existing documentation. Management's report on internal
25 control over financial reporting, required by subsection (a) of this section, and any
26 documentation provided in support thereof during the course of a financial condition
27 examination, shall be kept confidential by the Commissioner.

28 **"§ 58-10-260. Exemptions and effective dates.**

29 (a) Upon written application of any insurer, the Commissioner may grant an exemption
30 from compliance with any and all provisions of this Part if the Commissioner finds, upon
31 review of the application, that compliance with this Part would constitute a financial or
32 organizational hardship upon the insurer. An exemption may be granted at anytime and from
33 time to time for a specified period or periods. Within 10 days after a denial of an insurer's
34 written request for an exemption, the insurer may request in writing a hearing on its application
35 for an exemption. The hearing shall be held in accordance with Article 3A of Chapter 150B of
36 the General Statutes.

37 (b) Domestic insurers retaining a certified public accountant on the effective date of this
38 Part who qualify as independent shall comply with this Part for the year ending December 31,
39 2010, and each year thereafter unless the Commissioner permits otherwise.

40 (c) Foreign insurers shall comply with this Part for the year ending December 31, 2010,
41 and each year thereafter unless the Commissioner permits otherwise.

42 (d) The requirements of G.S. 58-10-210(d) shall become effective for audits of the year
43 beginning January 1, 2010, and each year thereafter.

44 (e) The requirements of G.S. 58-10-245 shall become effective on January 1, 2010. An
45 insurer or group of insurers that is not required to have independent audit committee members
46 or only a majority of independent audit committee members, as opposed to a supermajority,
47 because the total written and assumed premium is below the threshold and subsequently
48 becomes subject to one of the independence requirements due to changes in premium shall
49 have one year following the year the threshold is exceeded, but not earlier than January 1,
50 2010, to comply with the independence requirements. Likewise, an insurer that becomes
51 subject to one of the independence requirements as a result of a business combination shall

1 have one calendar year following the date of acquisition or combination to comply with the
2 independence requirements.

3 (f) The requirements of G.S. 58-10-255 become effective beginning with the reporting
4 period ending December 31, 2010, and each year thereafter. An insurer or group of insurers that
5 is not required to file a report because the total written premium is below the threshold and
6 subsequently becomes subject to the reporting requirements shall have two years following the
7 year the threshold is exceeded, but not earlier than December 31, 2010, to file a report. An
8 insurer acquired in a business combination shall have two calendar years after the date of
9 acquisition or combination to comply with the reporting requirements.

10 **"§ 58-10-265. Canadian and British companies.**

11 (a) In the case of Canadian and British insurers, the annual audited financial report shall
12 be defined as the annual statement of total business on the form filed by such companies with
13 their supervision authority duly audited by an independent chartered accountant.

14 (b) For such insurers, the letter required in G.S. 58-10-205(b) shall state that the
15 accountant is aware of the requirements relating to the annual audited financial report filed with
16 the Commissioner pursuant to G.S. 58-10-195 and shall affirm that the opinion expressed is in
17 conformity with those requirements."

18 **SECTION 2.** G.S. 58-23-26(a) and (c) read as rewritten:

19 "(a) Each pool shall have an annual audit by an independent certified public
20 ~~accountant,~~ accountant, pursuant to Part 7 of Article 10 of this Chapter, at the expense of the
21 pool, and shall make a copy of the audit available to the governing body or chief executive
22 officer of each member of the pool. A copy of the audit shall be filed with the Commissioner
23 within 130 days after the end of the pool's fiscal year, unless that time is extended by the
24 Commissioner. The annual audit shall report the financial position of the pool in conformity
25 with statutory accounting practices prescribed or permitted by the Commissioner.

26 ...

27 (c) Each pool is subject to G.S. 58-2-131, 58-2-132, 58-2-133, 58-2-134, 58-2-150,
28 58-2-155, 58-2-165, 58-2-180, 58-2-185, 58-2-190, 58-2-200, 58-3-71, 58-3-75, 58-3-81,
29 58-3-105, 58-6-5, 58-7-21, 58-7-26, 58-7-30, 58-7-31, 58-7-50, 58-7-55, 58-7-140, 58-7-160,
30 58-7-162, 58-7-163, 58-7-165, 58-7-167, 58-7-168, 58-7-170, 58-7-172, 58-7-173, 58-7-175,
31 58-7-179, 58-7-180, 58-7-183, 58-7-185, 58-7-187, 58-7-188, 58-7-192, 58-7-193, 58-7-197,
32 58-7-200, Part 7 of Article 10, and Articles 13, 19, and 34 of this Chapter. Annual financial
33 statements required by G.S. 58-2-165 shall be filed by each pool within 60 days after the end of
34 the pool's fiscal year, subject to extension by the Commissioner."

35 **SECTION 3.** G.S. 58-65-2 reads as rewritten:

36 **"§ 58-65-2. Other laws applicable to service corporations.**

37 The following provisions of this Chapter are applicable to service corporations that are
38 subject to this Article:

39 ...

40 Part 7 of Article 10. Annual Financial Reporting."

41 **SECTION 4.** G.S. 58-67-171 reads as rewritten:

42 **"§ 58-67-171. Other laws applicable to HMOs.**

43 The following provisions of this Chapter are applicable to HMOs that are subject to this
44 Article:

45 ...

46 Part 7 of Article 10. Annual Financial Reporting."

47 **SECTION 5.** This act is effective when it becomes law.