

3901-1-50

Annual financial reports.**(A) Purpose**

- (1) The purpose of this rule is to facilitate the department's surveillance of the financial condition of insurers by requiring (a) an annual audit of financial statements reporting the financial position and results of operation of insurers by independent certified public accountants, (b) communication of internal control related matters noted in an audit, and (c) management's report of internal control over financial reporting. This rule shall apply to all insurers, except those insurers having direct premiums written of less than one million dollars and having less than one thousand policyholders nationwide at the end of any year. Those insurers will be exempt from this rule for the year they do not meet this threshold unless the superintendent makes a specific finding that compliance by the insurer is necessary for the superintendent to carry out his or her statutory responsibilities. Insurers having assumed premiums to contracts and/or treaties of reinsurance of one million dollars or more will not be exempt. Insurers filing audited financial reports in another state, pursuant to such other state's requirement of audited financial reports, which are found by the superintendent to be substantially similar to the requirements herein, are exempt from this rule if:
 - (a) A copy of the audited financial report, communication of internal control related matters noted in audit, and the accountant's letter of qualifications, which are filed with such other states are filed with the superintendent in accordance with the filing dates specified in paragraphs (D), (K) and (L) of this rule. (Canadian insurers may submit accountants' reports as filed with the office of the superintendent of financial institutions, Canada); and
 - (b) A copy of any notification or report of adverse financial condition filed with such other state is filed with the superintendent within the time specified in paragraph (J) of this rule. Foreign or alien insurers required to file management's report of internal control over financial reporting in another state are exempt from filing the report in this state provided the other state has substantially similar reporting requirements and the report is filed with the superintendent of the other state within the time specified.
- (2) This rule shall not prohibit, preclude or in any way limit the superintendent from ordering, conducting and performing examinations of insurers under the rules and regulations and the practice and procedures of the department.

(B) Authority

This rule is promulgated pursuant to the authority vested in the superintendent under section 3901.041 of the Revised Code which requires the superintendent to adopt, amend, and rescind rules and make adjudications necessary to discharge his or her duties and exercise his or her powers under Title XXXIX of the Revised Code, subject to sections 119.01 to 119.13 of the Revised Code. This rule is issued to implement sections 3901.04, 3901.07 and 3901.77 of the Revised Code.

(C) Definitions

- (1) "Audited Financial Report" means the annual report defined in the items specified in paragraph (E) of this rule.
- (2) "Accountant" and "Independent Certified Public Accountant" mean an independent certified public accountant or accounting firm, as defined by the general standards of the "American Institute of Certified Public Accountants," in good standing with the "American Institute of Certified Public Accountants" and in all states in which it is licensed to practice; for Canadian and British companies, it means a Canadian-chartered or British-chartered accountant.
- (3) An "affiliate" of, or person "affiliated" with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.
- (4) "Audit committee" means a committee (or equivalent body) established by the board of directors of an entity for the purpose of overseeing the accounting and financial reporting process of an insurer or group of insurers, the internal audit function of an insurer or group of insurers (if applicable), and external audits of financial statements of the insurer or group of insurers. The audit committee of any entity that controls a group of insurers may be deemed to be the audit committee for one or more of these controlled insurers solely for the purposes of this rule at the election of the controlling person. Refer to paragraph (N) of this rule for exercising this election. If an audit committee is not designated by the insurer, the insurer's entire board of directors shall constitute the audit committee.
- (5) "Department" means the Ohio department of insurance.
- (6) "Indemnification" means an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the person or firm for failure to adhere to applicable auditing or professional standards, whether or not resulting in part from knowing of other misrepresentations made by the insurer or its representatives.

- (7) "Independent board member" has the same meaning as described in paragraph (N) of this rule.
- (8) "Internal audit function" means a person or persons that provide independent, objective and reasonable assurance designed to add value and improve an organization's operations and accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.
- (9) "Internal control over financial reporting" means a process effected by an entity's board of directors, management and other personnel designed to provide reasonable assurance regarding the reliability of the financial statements, i.e., those items specified in paragraphs (E)(2) to (E)(7) of this rule, and includes those policies and procedures that:
 - (a) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets;
 - (b) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements, i.e., these items specified in paragraphs (E)(2) to (E)(7) of this rule, and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and
 - (c) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements, i.e., these items specified in paragraphs (E)(2) to (E)(7) of this rule.
- (10) "SEC" means the United States securities and exchange commission.
- (11) "Section 404" means section 404 of the Sarbanes-Oxley Act of 2002 and the SEC's rules and regulations promulgated thereunder.
- (12) "Section 404 Report" means management's report on "internal control over financial reporting" as defined by the SEC and the related attestation report of the independent certified public accountant as described in paragraph (C)(2) of this rule.
- (13) "SOX Compliant Entity" means an entity that either is required to be compliant with, all of the following provisions of the Sarbanes-Oxley Act of 2002: (i) the preapproval requirements of section 201 (section 10A(i) of the Securities Exchange Act of 1934); (ii) the audit committee independence requirements of section 301 (section 10A(m)(3) of the Securities Exchange Act of 1934); and

- (iii) the internal control over financial reporting requirements of section 404 (item 308 of SEC regulation S-K0).
- (14) "Insurer" means ~~a~~ an entity licensed ~~insurer as defined in pursuant to Chapter 1738., 1739., 1751., 3907., 3909., 3911., 3925., 3929., 3931. or 3953. of the Revised Code.~~
- (15) "Group of Insurers" means those ~~licensed insurers~~ entities included in the reporting requirements of sections 3901.32 to 3901.37 of the Revised Code, or a set of insurers as identified by management, for the purpose of assessing the effectiveness of internal controls over financial reporting.
- (16) "Statutory accounting practices" has the meaning defined in the current editions of "Annual Statement Instructions" and the "Accounting Practices and Procedures Manual" published by the "National Association of Insurance Commissioners," or as otherwise prescribed by the insurance department of the insurer's state of domicile.
- (17) "Superintendent" means the superintendent of ~~insurance of the state of Ohio~~ the Ohio department of insurance.
- (18) "Workpapers" means 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 his or her audit of the financial statements of an insurer. Workpapers may include audit planning documentation, work programs, analyses, memoranda, letters of confirmation and representation, abstracts of company documents and schedules of commentaries prepared or obtained by the independent certified public accountant in the course of his or her audit of the financial statements of an insurer and, which support his or her opinion thereof.
- (D) General requirements related to filing and extensions for filing of audited financial reports and audit committee appointment

All insurers shall have an annual audit by an independent certified public accountant and shall file an audited financial report as a supplement to the annual statement with the superintendent on or before June first for the immediately preceding year ended December thirty-first. Extensions of the June first filing date may be granted in writing by the superintendent for thirty day periods upon showing by the insurer and its independent certified public accountant the reasons for requesting such extension and determination by the superintendent of good cause for an extension. The request for an extension must be submitted in writing not less than ten days prior to the due

date in sufficient detail to permit the superintendent to make an informed decision with respect to the requested extension.

If an extension is granted, a similar extension of thirty days is granted to the filing of management's report of internal control over financial reporting.

Every insurer required to file an annual audited financial report pursuant to this rule shall designate a group of individuals as constituting its audit committee, as defined in paragraph (C)(4) of this rule. The audit committee of any entity that controls an insurer may be deemed to be the insurer's audit committee for purposes of this rule at the election of the controlling person.

The superintendent may require an insurer to file an audited financial report earlier than June first with ninety days advance notice to the insurer.

(E) Contents of audited financial report

The audited financial report shall report 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. The audited financial report shall include the following items:

- (1) Report of independent certified public accountant;
- (2) Balance sheet reporting admitted assets, liabilities, capital and surplus;
- (3) Statement of operations;
- (4) Statement of cash flows;
- (5) Statement of changes in capital and surplus;
- (6) Notes to financial statements. These notes shall be those appropriate to a CPA audited financial report, based on applicability, materiality and significance, taking into account the subjects covered in the instructions to and illustrations of how to report information in the notes to financial statements section of the "NAIC" annual statement instructions and any other notes required by the "NAIC Accounting Practices and Procedures Manual" and shall include:
 - (a) A reconciliation of differences, if any, between the audited statutory financial statements and the annual financial statement filed with the superintendent including a written description of the nature of these differences; and

- (b) A narrative explanation of all significant intercompany transactions and balances; and
 - (c) A summary of ownership and relationships of the insurer and all affiliated companies.
- (7) 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 financial statement of the insurer filed with the superintendent and:
- (a) The financial statements shall be comparative, presenting the amounts as of December thirty-first of the current year and amounts as of the immediately preceding year ending December thirty-first. (However, in the first year in which an insurer is required to file an audited financial report, the comparative data may be omitted); and
 - (b) Amounts may be rounded to the nearest thousand dollars.

(F) Designation of independent certified public accountant

- (1) Each insurer required by this rule to file an audited financial report must, within sixty days after becoming subject to such requirement, register with the superintendent, in writing, the name and address of the independent certified public accountant retained to conduct the annual audit required in this rule. Insurers not previously retaining an independent certified public accountant shall register the name and address of their retained independent certified public accountant not less than six months before the date when the first audited financial report is to be filed.
- (2) The insurer shall obtain a letter from such accountant, and file a copy of such letter with the superintendent, stating that the accountant is aware of the provisions of the insurance code and the rules and regulations of the insurance department of its state of domicile that relate to accounting and financial matters and affirming that he or she will express his or her opinion on the financial statements of the insurer in the terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by such insurance department, specifying such exceptions as he or she may believe appropriate. If an accountant, who was not the accountant for the insurer's most recently filed audited financial report, is engaged to audit the insurer's financial statements, the insurer shall, within thirty days of the date the accountant is engaged, notify the department of this event.

- (3) If an accountant who was the accountant for the immediately preceding filed audited financial report is dismissed or resigns, the insurer shall within five business days notify the department of insurance of this event. The insurer shall also furnish the superintendent with a separate letter within ten business days of the above notification stating whether in the twenty four months preceding such engagement there were any disagreements with the former accountant on any 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 accountant, would have caused him or her to make reference to the subject matter of the disagreement in connection with his or her opinion. Disagreements contemplated by this paragraph are those that occur at the decision-making level, i.e., between personnel of the insurer responsible for presentation of its financial statements and personnel of the accounting firm responsible for rendering its report. The insurer shall also request, in writing, such former accountant to furnish a letter, addressed to the insurer, stating whether the accountant agrees with the statements contained in the insurer's letter and, if not, stating the reasons for which he or she does not agree; and the insurer shall furnish such responsive letter from the former accountant to the superintendent, together with its own letter.

(G) Qualifications of independent certified public accountant

An insurer may not use any person or firm as an independent certified public accountant if such person or firm: (1) is not in good standing with the "American Institute of Certified Public Accountants" in all states in which the person or firm is licensed to practice or, for a Canadian or British company, that is not a chartered accountant; (2) has either directly or indirectly entered into an agreement of indemnity or release from liability (collectively referred to as "indemnification") with respect to the audit of the insurer. Except as otherwise provided herein, an insurer may use a certified public accountant as its independent certified public accountant only if and for as long as such accountant conforms to the standards of his or her profession, as contained in the "Code of Professional Conduct" of the "American Institute of Certified Public Accountants" and "Rules of Professional Conduct" of the "Accountancy Board of Ohio," or similar code.

The lead (or coordinating) audit partner (having primary responsibility for the audit) may not act in that capacity for more than five consecutive years. The person shall be disqualified from acting in that or a similar capacity for the same company or its insurance subsidiaries or affiliates for a period of five consecutive years. An insurer may make application to the superintendent of insurance for relief from the above rotation requirement on the basis of unusual circumstances. This application should be made at least thirty days before the end of the calendar year. The superintendent may consider the following factors in determining if the relief should be granted:

(a) number of partners, expertise of the partners or the number of insurance clients in the currently registered firm; (b) premium volume of the insurer; or (c) number of jurisdictions in which the insurer transacts business. The insurers shall file, with its annual statement filing, the proof of relief from the five years limitation with the states that it is licensed in or doing business in and with the "National Association of Insurance Commissioners." If the nondomestic state accepts electronic files with the NAIC, the insurer shall file the approval in an electronic format acceptable to the "National Association of Insurance Commissioners."

The superintendent shall not recognize as a qualified independent certified public accountant, nor accept any annual audited financial report, prepared in whole or in part by, any natural person who (1) has been convicted of fraud, bribery, a violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. sections 1961-1968, or any dishonest conduct or practices under federal or state law; (2) has been found to have violated the insurance laws of this state with respect to any previous reports submitted under this rule; or (3) has demonstrated a pattern or practice of failing to detect or disclose material information in previous reports filed under the provisions of this requirement.

The superintendent may hold a hearing to determine whether a certified public accountant is qualified and, considering the evidence presented, may rule that the accountant is not qualified for purposes of expressing his or her opinion on the financial statements in the annual audited financial report made pursuant to this requirement and require the insurer to replace the accountant with another whose relationship with the insurer is qualified within the meaning of this requirement.

(1) The superintendent shall not recognize as a qualified independent certified public accountant, nor accept an annual audited financial report, prepared in whole or in part by an accountant who provides to an insurer, contemporaneously with the audit, the following non-audit services:

- (a) Bookkeeping or other services related to the accounting records or financial statements of the insurer;
- (b) Financial information systems design and implementation;
- (c) Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- (d) Actuarial-oriented advisory services involving the determination of amounts recorded in the financial statements. The accountant may assist an insurer in understanding the methods, assumptions and inputs used in the determination of amounts recorded in the financial statement only if it

is reasonable to conclude that the services provided will not be subject to audit procedures during an audit of the insurer's financial statements. An accountant's actuary may also issue an actuarial opinion or certification ("opinion") on an insurer's reserves if the following conditions have been met:

- (i) Neither the accountant nor the accountant's actuary has performed any management functions or made any management decisions:
- (ii) The insurer has competent personnel (or engages a third party actuary) to estimate the reserves for which management takes responsibility:
- (iii) The accountant's actuary tests the reasonableness of the reserves after the insurer's management has determined the amount of the reserves:

(e) Internal audit outsourcing services:

(f) Management functions or human resources:

(g) Broker or dealer, investment advisor, or investment banking services:

(h) Legal services or expert services unrelated to the audit: or

(i) Any other services that the superintendent determines, by rule, are impermissible.

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

Insurers having direct written and assumed premiums of less than one hundred million dollars in any calendar year may request an exemption from this paragraph. The insurer shall file with the superintendent a written statement discussing the reasons why the insurer should be exempt from these provisions. If the superintendent finds, upon review of this statement, that compliance with this rule would constitute a financial or organizational hardship upon the insurer, an exemption may be granted.

- (3) A qualified independent certified public accountant who performs the audit may engage in other non-audit services for an insurer, including tax services, that

are not described in paragraph (G)(1) of this rule or that do not conflict with paragraph (G)(2) of this rule, only if the activity is approved in advance by the audit committee for the insurer, in accordance with paragraph (G)(4) of this rule.

- (4) All auditing services and non-audit services provided to an insurer by the qualified independent certified public accountant of the insurer shall be preapproved by the audit committee of the insurer. The preapproval requirement is waived with respect to non-audit services if the insurer is a "SOX" compliant entity or a direct or indirect wholly-owned subsidiary of a "SOX" compliant entity or;
 - (a) The aggregate amount of all such non-audit services provided to the insurer constitutes not more than five per cent of the total amount of fees paid by the insurer to its qualified independent certified public account during the fiscal year in which the non-audit services are provided;
 - (b) The services were not recognized by the insurer at the time of the engagement to be non-audit services; and
 - (c) The services are promptly brought to the attention of the audit committee and approved prior to the completion of the audit by the audit committee or by one or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.
- (5) The audit committee of an insurer may delegate to one or more designated members of the audit committee the authority to grant the preapprovals required by paragraph (G)(4) of this rule. The decisions of any member to whom this authority is delegated shall be presented to the full audit committee at each of its scheduled meetings.
- (6) The superintendent shall not recognize an independent certified public accountant as qualified for particular insurer if a member of the board, president, chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for that insurer, was employed by the independent certified public accountant and participated in the audit of that insurer during the one year period preceding the date that the most current statutory opinion is due. This section shall only apply to partners and senior managers involved in the insurer's preceding audit. An insurer may make an application to the superintendent for relief from the requirement on the basis of unusual circumstances.

- (7) The insurer shall file, with its annual statement filing, the approval for relief from paragraph (G)(6) of this rule with the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

(H) Consolidated or combined audits

An insurer may make an annual written application to the superintendent for approval to file audited consolidated or combined financial statements in lieu of separate annual audited financial statements if the insurer is part of a group of insurance companies which utilizes a pooling or one hundred percent reinsurance agreement that affects the solvency and integrity of the insurer's reserves and such insurer cedes all of its direct and assumed business to the pool. In such cases, a columnar consolidating or combining worksheet shall be filed with the report, as follows:

- (1) Amounts shown on the consolidated or combined audited financial report shall be shown on the worksheet;
- (2) Amounts for each insurer subject to this rule shall be stated separately;
- (3) Non-insurance operations may be shown on the worksheet on a combined or individual basis;
- (4) Explanations of consolidating and eliminating entries shall be included; and
- (5) A reconciliation shall be included of any differences between the amounts shown in the individual insurer columns of the worksheet and comparable amounts shown on the financial statements of the insurers.

(I) Scope of audit and report of independent certified public accountant

Financial statements furnished pursuant to paragraph (E) of this rule shall be examined by an independent certified public accountant. The audit of the insurer's financial statements shall be conducted in accordance with generally accepted auditing standards. In accordance with AU section 319 of the professional standards of the accountants "American Institute of Certified Public Accountants," consideration of internal control in a financial statement audit, the independent certified public accountant should obtain an understanding of internal control sufficient to plan the audit. To the extent required by AU section 319, for those insurers required to file a management's report of internal control over financial reporting pursuant to paragraph (Q) of this rule, 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. Consideration should be given to such other standards illustrated in the "Financial Condition Examiner's Handbook" promulgated by the "National Association of Insurance Commissioners" as the independent certified public accountant deems necessary.

(J) Notification of adverse financial condition

- (1) The insurer required to furnish the annual audited financial report shall require the independent certified public accountant to report in writing within five business days to the board of directors or its audit committee any determination by the independent certified public accountant that the insurer has materially misstated its financial condition as reported to the superintendent as of the balance sheet date currently under audit or that the insurer does not meet the minimum capital and surplus requirement of the Revised Code as of that date. An insurer who has received a report pursuant to this paragraph shall forward a copy of the report to the superintendent within five business days of receipt of such report and shall provide the independent certified public accountant making the report with evidence of the report being furnished to the superintendent. If the independent certified public accountant fails to receive such evidence within the required five business day period, the independent certified public accountant shall furnish to the superintendent a copy of its report within the next five business days.
- (2) No independent certified public accountant shall be liable in any manner to any person for any statement made in connection with the above paragraph if such statement is made in good faith in compliance with the above paragraph.
- (3) If the accountant, subsequent to the date of the audited financial report filed pursuant to this rule, becomes aware of facts which might have affected his or her report, the department shall note the obligation of the accountant to take such action as prescribed in volume one, section AU five hundred sixty one of the "Professional Standards of the American Institute of Certified Public Accountants," as amended.

(K) Communication of internal control related matters noted in an audit

In addition to the annual audited financial report, each insurer shall furnish the superintendent with a written communication as to any unremediated material weakness in its internal controls over financial reporting noted during the audit. Such communication shall be prepared by the accountant within sixty days after the filing of the annual audited financial report, and shall contain:

- (1) A description of any unremediated material weakness (as the term material weakness is defined by statement on auditing standard sixty, communication of internal control related matters noted in an audit, or its replacement) as of December thirty-first immediately preceding (so as to coincide with the audited financial report discussed in paragraph (D) of this rule) in the insurer's internal control over financial reporting noted by the accountant during the course of their audit of the financial statements. If no unremediated material weaknesses are noted, the communication should so state.
- (2) The insurer is required to provide a description of remedial action taken or proposed to correct unremediated material weaknesses, if the actions are not described in the accountant's communications.

(L) Accountant's letter of qualifications

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

- (1) That he or she is independent with respect to the insurer and conforms to the standards of his or her profession as contained in the "Code of Professional Ethics" and pronouncements of the "American Institute of Certified Public Accountants" and the "Rules of Professional Conduct" of the "Accountancy Board of Ohio" or other state board of public accountancy that performs the same licensing function.
- (2) The background and experience in general, and the experience in audits of insurers of the staff assigned to the engagement and whether each is an independent certified public accountant. Nothing within this requirement shall be construed as prohibiting the accountant from utilizing such staff as he or she deems appropriate where such use is consistent with the standards prescribed by generally accepted auditing standards.
- (3) That the accountant understands the annual audited financial report and his or her opinion thereon will be filed in compliance with this requirement and that the superintendent will be relying on this information in the monitoring and regulation of the financial position of insurers.
- (4) That the accountant consents to the requirements of paragraph (M) of this rule and that the accountant consents and agrees to make available for review by the superintendent his or her designee or his or her appointed agent, the workpapers, as defined in paragraph (C)(18) of this rule.

(5) A representation that the accountant is properly licensed by ~~the "Accountancy Board of Ohio"~~ and that he or she an appropriate state licensing authority and is a member in good standing in the "American Institute of Certified Public Accountants."

(6) A representation that the accountant is in compliance with the requirements of paragraph (G) of this rule.

(M) Availability and maintenance of independent certified public accountant workpapers

Every insurer required to file an audited financial report pursuant to this rule shall require the accountant to make available for review by department examiners the workpapers prepared in the conduct of his or her audit and any communications related to the audit between the accountant and the insurer, at the offices of the insurer, at the department, or at any other reasonable place designated by the superintendent. The insurer shall require that the accountant retain the workpapers and communications until the domiciliary department has filed a report on examination covering the period of the audit, but for no longer than seven years from the date of the audit report.

In the conduct of the aforementioned periodic review by the domiciliary department examiners, it shall be agreed that photocopies of pertinent audit workpapers may be made and retained by the domiciliary department. Such reviews by the domiciliary department examiners shall be considered investigations and all workpapers and communications obtained during the course of such investigations shall be afforded the same confidentiality as other examination workpapers generated by the domiciliary department.

(N) Requirements for audit committees

This section shall not apply to foreign or alien insurers licensed in this state or an insurer that is a "SOX" compliant entity or a direct or indirect wholly-owned subsidiary of a "SOX" compliant entity.

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

The audit committee of an insurer or group of insurers shall be responsible for overseeing the insurer's internal audit function and granting the person or persons

performing the function suitable authority and resources to fulfill their responsibilities if required by paragraph (O) of this rule.

Each member of the audit committee shall be a member of the board of directors of the insurer or a member of the board of directors of an entity elected pursuant to this paragraph and paragraph (C)(4) of this rule.

In order to be considered independent for purposes of this rule, a member of the audit committee may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee, accept any consulting, advisory or other compensatory fee from the entity or be an affiliated person of the entity or any subsidiary thereof. However, if law requires the board participation by otherwise non-independent members, that law shall prevail and such members may participate in the audit committee and be designated as independent for audit committee purposes, unless they are an officer or employee of the insurer or one of its affiliates.

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

To exercise the election of the controlling person to designate the audit committee for purposes of this rule, the ultimate controlling person shall provide written notice to the domiciliary commissioners of the affected insurers. Notification shall be made timely prior to the issuance of the statutory audit report and include a description of the basis for the election. The election can be changed through notice to the domiciliary commissioner by the insurer, which shall include a description of the basis for the change. The election shall remain in effect for perpetuity, until rescinded.

The audit committee shall require the accountant that performs for an insurer any audit required by this regulation to timely report to the audit committee in accordance with the requirements of "SAS" No. 61, "Communication with Audit Committees," or its replacement, including: All significant accounting policies and material permitted practices; All material alternative treatments of financial information within statutory accounting principles that have been discussed with management officials of the insurer, ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the accountant; and other material written communications between the accountant and the management of the insurer, such as any management letter or schedule of unadjusted differences.

If an insurer is a member of an insurance holding company system, the reports required above may be 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.

The portion of independent audit committee members shall meet or exceed the following criteria:

Prior Calendar Year Direct Written and Assumed Premiums

\$0- \$300,000,000	\$300,000,000- \$500,000,000	Over \$500,000,000
No minimum requirements. See also note A and B.	Majority (50% or more) of members shall be independent. See also note A and B.	Supermajority of members (75% or more) shall be independent. See also Note A and B.

Note A: The superintendent has authority afforded by state law to require the entity's board to enact improvements to the independence of the audit committee membership if the insurer is in a "RBC" 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.

Note B: All insurers with less than five hundred million dollars in prior year direct written and assumed premiums are encouraged to structure their audit committees with at least a supermajority of independent audit committee members.

Note C: Prior calendar year direct written and assumed premiums shall be the combined total of direct premiums and assumed premiums from non-affiliates for the reporting entities.

An insurer with direct written and assumed premium, excluding premiums reinsured with the federal crop insurance corporation and federal flood program, less than five hundred million dollars may make application to the superintendent for a waiver from these requirements based upon hardship. The insurer shall file, with its annual statement filing, the approval for relief from paragraph (N) of this rule with the states that it is licensed in or doing business in and the NAIC. If the non-domestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

(O) Internal audit function requirements

(1) An insurer is exempt from the requirements of paragraph (O) of this rule if:

- (a) The insurer has annual direct written and unaffiliated assumed premium, including international direct and assumed premium but excluding premiums reinsured with the "Federal Crop Insurance Corporation" and "Federal Flood Program," less than five hundred million dollars; and
 - (b) If the insurer is a member of a group of insurers that has an annual direct written and unaffiliated assumed premium including international direct and assumed premium, but excluding premiums reinsured with the "Federal Crop Insurance Corporation" and "Federal Flood Program," less than one billion dollars.
 - (2) The insurer or group of insurers shall establish an internal audit function providing independent, objective and reasonable assurance to the audit committee and insurer management regarding the insurer's governance, risk management and internal controls. This assurance shall be provided by performing general and specific audits, reviews and tests and by employing other techniques deemed necessary to protect assets, evaluate control effectiveness and efficiency, and evaluate compliance with policies and regulations.
 - (3) In order to ensure that internal auditors remain objective, the internal audit function must be organizationally independent. Specifically, the internal audit function will not defer ultimate judgment on audit matters to others, and shall appoint an individual to head the internal audit function who will have direct and unrestricted access to the board of directors. Organizational independence does not preclude dual-reporting relationships.
 - (4) The head of internal audit function shall report to the audit committee regularly, but no less than annually, on the periodic audit plan, factors that may adversely impact the internal audit function's independence or effectiveness, material findings from completed audits and the appropriateness of corrective actions implemented by management as a result of audit findings.
 - (5) If an insurer is a member of an insurance holding company system or included in a group of insurers, the insurer may satisfy the internal audit function requirements set forth in paragraph (O) of this rule at the ultimate controlling parent level, an intermediate holding company level or the individual legal entity level.
- (P) Conduct of insurer in connection with the preparation of required reports and documents

No director or officer of an insurer shall, directly or indirectly:

- (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 rule; or
- (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 rule.

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 rule if that person knew or should have known that the action, if successful, could result in rendering the insurer's financial statements materially misleading.

Actions that, "if successful, could result in rendering the insurer's financial statements materially misleading" include, but are not limited to, actions taken at any time with respect to the professional engagement period to coerce, manipulate, mislead or fraudulently influence an accountant:

- (a) To issue or reissue a report on an insurer's financial statements that is not warranted in the circumstances (due to material violations of statutory accounting principles prescribed by the commissioner, generally accepted auditing standards, or other professional or regulatory standards):
- (b) Not to perform audit, review or other procedures required by generally accepted auditing standards or other professional standards;
- (c) Not to withdraw an issued report; or
- (d) Not to communicate matters to an insurer's audit committee.

(Q) Management's report of internal control over financial reporting

Every insurer required to file an audited financial report pursuant to this rule that has annual direct written and assumed premiums, excluding premiums reinsured with the federal crop insurance corporation and federal flood program, of five hundred million dollars or more shall prepare a report of the insurer's or group of insurer's internal control over financial reporting as these terms are defined in paragraph (C) of this rule. The report shall be filed with the superintendent along with the communication of internal control related matters noted in an audit described in paragraph (K) of this

rule. Management's report of internal control over financial reporting shall be as of December thirty-first immediately preceding.

Notwithstanding the premium threshold, as stated above, the superintendent may require an insurer to file management's report of internal control over financial reporting if the insurer is in any "RBC" level event, or meets any one or more of the standards of an insurer deemed to be in hazardous financial condition as defined in sections ~~3903.01 to 3903.59~~ 3903.09 and 3903.71 of the Revised Code and rule 3901-3-04 of the Administrative Code.

An insurer or a group of insurers that is:

- (1) Directly subject to "Section 404";
- (2) Part of a holding company system whose parent is directly subject to "Section 404";
- (3) Not directly subject to "Section 404" but is a "SOX" compliant entity; or
- (4) A member of a holding company system whose parent is not directly subject to "Section 404" but is a "SOX" compliant entity;

may file its or its parents "Section 404" report on internal control and an addendum in satisfaction of this paragraph's requirement provided that those internal controls of the insurer or group of insurers having a material impact on the preparation of the insurer or group of insurers' its audited statutory financial statements were included in the scope of the "Section 404" reports. The addendum shall be a positive statement by management that there are no material processes with respect to the preparation of the insurer's or group of insurers' audited statutory financial statements excluded from the "Section 404" report. If there are internal controls of the insurer or group of insurers that have a material impact on the preparation of the insurer's or group of insurers' audited statutory financial statements and those internal controls were not included in the scope of the "Section 404" report, the insurer or group of insurers may either file (a) a report as required by paragraph (Q) of this rule, or (b) the "Section 404" report and a report as required by paragraph (Q) of this rule for those internal controls that have a material impact on the insurer's or group of insurers' audited statutory financial statements not covered by the "Section 404" report.

Management's report of internal control over financial reporting shall include:

- (a) A statement that management is responsible for establishing and maintaining adequate control over financial reporting;

- (b) A statement that management has established internal control over financial reporting and an 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;
- (c) A statement that briefly describes the approach or process by which management evaluated the effectiveness of its internal control over financial reporting;
- (d) A statement that briefly describes the scope of work that is included and whether any internal controls were excluded;
- (e) Disclosure of any unremediated material weaknesses in internal control over financial reporting identified by management as of December thirty-first immediately preceding. Management is not permitted to conclude that the internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles if there is one or more unremediated material weakness in its internal controls over financial reporting;
- (f) A statement regarding the inherent limitations of internal control systems; and
- (g) Signatures of the chief executive officer and the chief financial officer (or equivalent position/title).

Management shall document and make available upon financial condition examination the basis upon which its assertions, required in above, are made. Management may base its assertions, in part, upon its review, monitoring and testing of internal controls undertaken in the normal course of its activities.

- (i) Management shall have discretion as to the nature of the internal control framework used, and the nature and extent of documentation, in order to make its assertion in a cost effective manner, as such, may include assembly of or reference to existing documentation.
- (ii) Management's report on internal control over financial reporting, required above, and any documentation provided in support thereof

during the course of a financial condition examination, shall be kept confidential by the superintendent.

(R) Exemptions and effective dates

- (1) Upon written application of any insurer, the superintendent may grant an exemption from compliance with any and all provisions this rule if the superintendent finds, upon review of the application, that compliance with this rule would constitute a financial or organizational hardship upon the insurer. An exemption may be granted at any time and from time to time for any specified period. Domestic insurers retaining an independent certified public accountant on the effective date of this rule shall comply with this rule for the year ending December 31, 2008, and each year thereafter unless the superintendent permits otherwise. Domestic insurers not retaining an independent certified public accountant on the effective date of this rule shall meet the following schedule for compliance, unless the superintendent gives his or her written permission otherwise.
 - (a) For the year ending December 31, 2008, file with the superintendent an audited financial report:
 - (b) For the year ending December 31, 2009, and each year thereafter, such insurers shall file with the superintendent all reports and communications required by this rule.
- (2) Foreign insurers shall comply with this rule for the year ending December 31, 2009, and each year thereafter, unless the superintendent gives his or her written permission otherwise.
- (3) The requirements of paragraph (G) of this rule shall be in effect for audits of the year beginning January 1, 2010 and thereafter.
- (4) The requirements of paragraph (N) of this rule are to be in effect January 1, 2010. An insurer or group of insurers that is not required to have independent audit committee members or only a majority of independent audit committee members (as opposed to a supermajority) because the total written and assumed premium is below the threshold and subsequently becomes subject to one of the independence requirements due to changes in premium shall have one year following the year threshold is exceeded (but not earlier than January 1, 2010) to comply with the independence requirements. Likewise, an insurer that becomes subject to one of the independence requirements as a result of a business combination shall have one calendar year following the date of acquisition or combination to comply with the independence requirements.

(5) The requirements of paragraph (O) of this rule are to be in effect January 1, 2016. If an insurer or group of insurers that is exempt from paragraph (O) of this rule requirements no longer qualifies for the exemption, it shall have one year after the threshold is exceeded to comply with the requirements of paragraph (O) of this rule.

~~(5)(6)~~ The requirements of paragraph (Q) of this rule ~~and other modified sections (identify modified sections)~~, except for paragraph (N) of this rule covered above, are effective beginning with the reporting period December 31, 2010 and each year thereafter. An insurer or group of insurers that is not required to file a report because the total written premium is below the threshold and subsequently becomes subject to the reporting requirements shall have two years following the year the threshold is exceeded (but not earlier than December 31, 2010) to file a report. Likewise, an insurer acquired in a business combination shall have two calendar years following the date of acquisition or combination to comply with the reporting requirements.

(S) Canadian and British companies

In the case of Canadian and British insurers, the audited financial report shall be defined as the annual statement of total business on the form filed by such companies with their domiciliary supervision authority duly audited by an independent chartered accountant. For such insurers, the letter required in paragraph (F)(2) of this rule shall state that the accountant is aware of the requirements relating to the audited financial report filed with the superintendent pursuant to paragraph (Q) of this rule and shall affirm that the opinion expressed is in conformity with such requirements.

(T) Severability

If any paragraph, term or provision of this rule is adjudged invalid for any reason, the judgment shall not affect, impair or invalidate any other paragraph, term or provision of this rule, but the remaining paragraphs, terms and provisions shall be and continue in full force and effect.

Effective: 5/9/2021

Five Year Review (FYR) Dates: 2/22/2021 and 08/30/2025

CERTIFIED ELECTRONICALLY

Certification

04/29/2021

Date

Promulgated Under: 119.03

Statutory Authority: 3901.041

Rule Amplifies: 3901.07, 3901.77

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