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H.B. No. 2752

A BILL TO BE ENTITLED

AN ACT

relating to independent audits of insurer financial statements and insurer internal controls.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

SECTION 1. Section 401.001, Insurance Code, is amended by adding Subdivisions (2-a), (2-b), (4-a), (4-b), (6), (7), (8), and (9) and amending Subdivision (4) to read as follows:

(2-a) "Audit committee" means a committee established by the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of an insurer or group of insurers and auditing financial statements of the insurer or group of insurers. At the election of the controlling person, the audit committee of an entity that controls a group of insurers may be the audit committee for one or more of the controlled insurers solely for the purposes of this subchapter. If an audit committee is not designated by the insurer, the insurer's entire board of directors constitutes the audit committee.

(2-b) "Group of insurers" means those authorized insurers included in the reporting requirements of Chapter 823, or a set of insurers as identified by management, for the purpose of assessing the effectiveness of internal control over financial reporting.

(4) "Insurer" means an insurer authorized to engage in business in this state, including:

- 1 (A) a life, health, or accident insurance
2 company;
- 3 (B) a fire and marine insurance company;
- 4 (C) a general casualty company;
- 5 (D) a title insurance company;
- 6 (E) a fraternal benefit society;
- 7 (F) a mutual life insurance company;
- 8 (G) a local mutual aid association;
- 9 (H) a statewide mutual assessment company;
- 10 (I) a mutual insurance company other than a
11 mutual life insurance company;
- 12 (J) a farm mutual insurance company;
- 13 (K) a county mutual insurance company;
- 14 (L) a Lloyd's plan;
- 15 (M) a reciprocal or interinsurance exchange;
- 16 (N) a group hospital service corporation;
- 17 (O) a stipulated premium company; ~~and~~
- 18 (P) a nonprofit legal services corporation; and
- 19 (Q) a health maintenance organization.

20 (4-a) "Internal control over financial reporting"
21 means a process implemented by an entity's board of directors,
22 management, and other personnel designed to provide reasonable
23 assurance regarding the reliability of the entity's financial
24 statements. The term includes policies and procedures that:

- 25 (A) relate to the maintenance of records that, in
26 reasonable detail, accurately and fairly reflect the transactions
27 and dispositions of assets;

1 (B) provide reasonable assurance that:

2 (i) transactions are recorded as necessary
3 to permit preparation of the financial statements; and

4 (ii) receipts and expenditures are made
5 only in accordance with authorizations of management and directors;
6 and

7 (C) provide reasonable assurance regarding
8 prevention or timely detection of unauthorized acquisition, use, or
9 disposition of assets that could have a material effect on the
10 financial statements.

11 (4-b) "Management" means the management of an insurer
12 or group of insurers subject to this subchapter.

13 (6) "SEC" means the United States Securities and
14 Exchange Commission.

15 (7) "Section 404" means Section 404, Sarbanes-Oxley
16 Act of 2002 (15 U.S.C. Section 7262), and rules adopted under that
17 section.

18 (8) "Section 404 report" means management's report on
19 internal control over financial reporting as determined by the SEC
20 and the related attestation report of an accountant.

21 (9) "SOX-compliant entity" means an entity that is
22 required to comply with or voluntarily complies with:

23 (A) the preapproval requirements provided by 15
24 U.S.C. Section 78j-1(i);

25 (B) the audit committee independence
26 requirements provided by 15 U.S.C. Section 78j-1(m)(3); and

27 (C) the internal control over financial

1 reporting requirements provided by 15 U.S.C. Section 7262(b) and
2 Item 308, SEC Regulation S-K.

3 SECTION 2. Sections 401.002, 401.003, and 401.004,
4 Insurance Code, are amended to read as follows:

5 Sec. 401.002. PURPOSE OF SUBCHAPTER. The purpose of this
6 subchapter is to:

7 (1) require an annual audit by an independent
8 certified public accountant of the financial statements reporting
9 the financial condition and the results of operations of each
10 insurer;

11 (2) require communication of internal control related
12 matters noted in an audit; and

13 (3) require management to report on internal control
14 over financial reporting [~~or health maintenance organization~~].

15 Sec. 401.003. EFFECT OF SUBCHAPTER ON AUTHORITY TO EXAMINE.
16 This subchapter does not limit the commissioner's authority to
17 order or the department's authority to conduct an examination of an
18 insurer [~~or health maintenance organization~~] under this code or the
19 commissioner's rules.

20 Sec. 401.004. FILING AND EXTENSIONS FOR FILING OF AUDITED
21 FINANCIAL REPORT. (a) Unless exempt under Section 401.006,
22 401.007, or 401.008 and except as otherwise provided by Sections
23 401.005 and 401.016, an insurer [~~or health maintenance~~
24 ~~organization~~] shall:

25 (1) have an annual audit performed by an accountant;
26 and

27 (2) file with the commissioner on or before June 30 an

1 audited financial report for the preceding calendar year.

2 (b) The commissioner may require an insurer [~~or health~~
3 ~~maintenance organization~~] to file an audited financial report on a
4 date that precedes June 30. The commissioner must notify the
5 insurer [~~or health maintenance organization~~] of the filing date not
6 later than the 90th day before that date.

7 (c) An insurer [~~or health maintenance organization~~] may
8 request an extension of the filing date by submitting the request in
9 writing before the 10th day preceding the filing date. The request
10 must include sufficient detail for the commissioner to make an
11 informed decision on the requested extension. The commissioner
12 may extend the filing date for one or more 30-day periods if the
13 commissioner determines that there is good cause for the extension
14 based on a showing by the insurer [~~or health maintenance~~
15 ~~organization~~] and the insurer's [~~or health maintenance~~
16 ~~organization's~~] accountant of the reasons for requesting the
17 extension. An extension granted under this subsection also applies
18 to the filing of management's report on internal control over
19 financial reporting.

20 (d) An insurer required to file an annual audited financial
21 report under this subchapter shall designate a group of individuals
22 to serve as its audit committee. The audit committee of an entity
23 that controls an insurer may, at the election of the controlling
24 person, be the insurer's audit committee for purposes of this
25 subchapter.

26 SECTION 3. The heading to Section 401.005, Insurance Code,
27 is amended to read as follows:

1 Sec. 401.005. ALTERNATIVE FILING FOR CANADIAN OR BRITISH
2 INSURERS [~~OR HEALTH MAINTENANCE ORGANIZATIONS~~].

3 SECTION 4. Section 401.005(a), Insurance Code, is amended
4 to read as follows:

5 (a) Instead of the audited financial report required by
6 Section 401.004, an insurer [~~or health maintenance organization~~]
7 domiciled in Canada or the United Kingdom may file the insurer's [~~or~~
8 ~~health maintenance organization's~~] annual statement of total
9 business on the form filed by the insurer [~~or health maintenance~~
10 ~~organization~~] with the appropriate regulatory authority in the
11 country of domicile. The statement must be audited by an
12 independent accountant chartered in the country of domicile.

13 SECTION 5. Section 401.006, Insurance Code, is amended to
14 read as follows:

15 Sec. 401.006. EXEMPTION FOR CERTAIN SMALL INSURERS [~~AND~~
16 ~~HEALTH MAINTENANCE ORGANIZATIONS~~]. (a) An insurer [~~or health~~
17 ~~maintenance organization~~] that has less than \$1 million in direct
18 premiums written in this state during a calendar year is exempt from
19 the requirement to file an audited financial report if the insurer
20 [~~or health maintenance organization~~] submits an affidavit, made
21 under oath by one of the insurer's [~~or health maintenance~~
22 ~~organization's~~] officers, that specifies the amount of direct
23 premiums written in this state during that period.

24 (b) Notwithstanding Subsection (a), the commissioner may
25 require an insurer [~~or health maintenance organization~~], other than
26 a fraternal benefit society that does not have any direct premiums
27 written in this state for accident and health insurance during a

1 calendar year, to comply with this subchapter if the commissioner
2 finds that the insurer's [~~or health maintenance organization's~~]
3 compliance is necessary for the commissioner to fulfill the
4 commissioner's statutory responsibilities.

5 (c) An insurer [~~or health maintenance organization~~] that
6 has assumed premiums of at least \$1 million under reinsurance
7 agreements is not exempt under Subsection (a).

8 SECTION 6. The heading to Section 401.007, Insurance Code,
9 is amended to read as follows:

10 Sec. 401.007. EXEMPTION FOR CERTAIN FOREIGN OR ALIEN
11 INSURERS [~~OR HEALTH MAINTENANCE ORGANIZATIONS~~].

12 SECTION 7. Sections 401.007(a) and (b), Insurance Code, are
13 amended to read as follows:

14 (a) A foreign or alien insurer [~~or health maintenance~~
15 ~~organization~~] that files an audited financial report in another
16 state in accordance with that state's requirements for audited
17 financial reports may be exempt from filing a report under this
18 subchapter if the commissioner finds that the other state's
19 requirements are substantially similar to the requirements
20 prescribed by this subchapter.

21 (b) An insurer [~~or health maintenance organization~~] exempt
22 under this section shall file with the commissioner a copy of:

23 (1) the audited financial report, the report on
24 significant deficiencies in internal controls, and the
25 accountant's letter of qualifications filed with the other state;
26 and

27 (2) any notification of adverse financial conditions

1 report filed with the other state.

2 SECTION 8. Section 401.008, Insurance Code, is amended to
3 read as follows:

4 Sec. 401.008. HARDSHIP EXEMPTION. (a) An insurer [~~or~~
5 ~~health maintenance organization~~] that is not eligible for an
6 exemption under Section 401.006 or 401.007 may apply to the
7 commissioner for a hardship exemption.

8 (b) Subject to Subsection (c), the commissioner may grant an
9 exemption under this section if the commissioner finds, after
10 reviewing the application, that compliance with this subchapter
11 would constitute a severe financial or organizational hardship for
12 the insurer [~~or health maintenance organization~~]. The
13 commissioner may grant the exemption at any time for one or more
14 specified periods.

15 (c) The commissioner may not grant an exemption under this
16 section if:

17 (1) the exemption would diminish the department's
18 ability to monitor the financial condition of the insurer [~~or~~
19 ~~health maintenance organization~~]; or

20 (2) the insurer [~~or health maintenance organization~~]:

21 (A) during the five-year period preceding the
22 date the application for the exemption is made:

23 (i) has been placed under supervision,
24 conservatorship, or receivership;

25 (ii) has undergone a change in control, as
26 described by Section 823.005; or

27 (iii) has been subject to a significant

1 number of complaints, as determined by the commissioner;

2 (B) has been identified by the department as
3 troubled;

4 (C) has been or is the subject of a disciplinary
5 action by the department; or

6 (D) is not complying with the law or with a rule
7 adopted by the commissioner.

8 SECTION 9. Sections 401.009(a), (b), and (c), Insurance
9 Code, are amended to read as follows:

10 (a) An audited financial report required under Section
11 401.004 must:

12 (1) describe the financial condition of the insurer
13 [~~or health maintenance organization~~] as of the end of the most
14 recent calendar year and the results of the insurer's [~~or health~~
15 ~~maintenance organization's~~] operations, changes in financial
16 position, and changes in capital and surplus for that year;

17 (2) conform to the statutory accounting practices
18 prescribed or otherwise permitted by the insurance regulator in the
19 insurer's [~~or health maintenance organization's~~] state of domicile;
20 and

21 (3) include:

22 (A) the report of an accountant;

23 (B) a balance sheet that reports admitted assets,
24 liabilities, capital, and surplus;

25 (C) a statement of gain or loss from operations;

26 (D) a statement of cash flows;

27 (E) a statement of changes in capital and

1 surplus;

2 (F) any notes to financial statements;

3 (G) supplementary data and information,
4 including any additional data or information required by the
5 commissioner; and

6 (H) information required by the department to
7 conduct the insurer's [~~or health maintenance organization's~~]
8 examination under Subchapter B.

9 (b) The notes to financial statements required by
10 Subsection (a)(3)(F) must include:

11 (1) a reconciliation of any differences between the
12 audited statutory financial statements and the annual statements
13 filed under this code, with a written description of the nature of
14 those differences;

15 (2) any notes required by the appropriate National
16 Association of Insurance Commissioners annual statement
17 instructions or by generally accepted accounting principles; and

18 (3) a summary of the ownership of the insurer [~~or~~
19 ~~health maintenance organization~~] and that entity's relationship to
20 any affiliated company.

21 (c) An insurer [~~or health maintenance organization~~]
22 required under Section 401.004 to file an audited financial report
23 that does not retain an independent certified public accountant to
24 perform an annual audit for the previous year may not be required to
25 include in the report audited statements of operations, cash flows,
26 or changes in capital and surplus for the first year. The insurer
27 [~~or health maintenance organization~~] must include those statements

1 in the first-year report and label the statements as
2 unaudited. The insurer [~~or health maintenance organization~~] must
3 include in the first-year report all other reports described by
4 Section 401.004.

5 SECTION 10. Section 401.010, Insurance Code, is amended to
6 read as follows:

7 Sec. 401.010. REQUIREMENTS FOR FINANCIAL STATEMENTS IN
8 AUDITED FINANCIAL REPORT. (a) An accountant must audit the
9 financial reports provided by an insurer [~~or health maintenance~~
10 ~~organization~~] for purposes of an audit under this subchapter. The
11 accountant who audits the reports must conduct the audit in
12 accordance with generally accepted auditing standards or with
13 standards adopted by the Public Company Accounting Oversight Board,
14 as applicable, and must consider the standards specified in the
15 Financial Condition Examiner's Handbook adopted by the National
16 Association of Insurance Commissioners or other analogous
17 nationally recognized standards adopted by commissioner rule.

18 (a-1) In accordance with "Consideration of Internal Control
19 in a Financial Statement Audit," AU Section 319, Professional
20 Standards of the American Institute of Certified Public
21 Accountants, the accountant shall obtain an understanding of
22 internal control sufficient to plan the audit. To the extent
23 required by AU Section 319, for those insurers required to file a
24 management's report of internal control over financial reporting
25 under Section 401.024, the accountant shall consider the most
26 recently available report in planning and performing the audit of
27 the statutory financial statements. In this subsection, "consider"

1 has the meaning assigned by Statement on Auditing Standards No.
2 102, "Defining Professional Requirements in Statements on Auditing
3 Standards," or a successor document.

4 (b) The financial statements included in the audited
5 financial report must be prepared in a form and using language and
6 groupings substantially the same as those of the relevant sections
7 of the insurer's [~~or health maintenance organization's~~] annual
8 statement filed with the commissioner. Beginning in the second
9 year in which an insurer [~~or health maintenance organization~~] is
10 required to file an audited financial report, the financial
11 statements must also be comparative, presenting the amounts as of
12 December 31 of the reported year and the amounts as of December 31
13 of the preceding year.

14 SECTION 11. Section 401.011, Insurance Code, is amended by
15 amending Subsections (a), (b), and (c) and adding Subsections
16 (c-1), (e), (f), (g), (h), (i), (j), (k), (l), and (m) to read as
17 follows:

18 (a) Except as provided by Subsections (c), [~~and~~] (d), (e),
19 (f), (g), and (l), the commissioner shall accept an audited
20 financial report from an independent certified public accountant or
21 accounting firm that:

22 (1) is a member in good standing of the American
23 Institute of Certified Public Accountants and is in good standing
24 with all states in which the accountant or firm is licensed to
25 practice, as applicable; and

26 (2) conforms to the American Institute of Certified
27 Public Accountants Code of Professional Conduct and to the rules of

1 professional conduct and other rules of the Texas State Board of
2 Public Accountancy or a similar code.

3 (b) If the insurer [~~or health maintenance organization~~] is
4 domiciled in Canada, the commissioner shall accept an audited
5 financial report from an accountant chartered in Canada. If the
6 insurer [~~or health maintenance organization~~] is domiciled in Great
7 Britain, the commissioner shall accept an audited financial report
8 from an accountant chartered in Great Britain.

9 (c) A lead partner or other person responsible for rendering
10 a report for an insurer [~~or health maintenance organization~~] for
11 five [~~seven~~] consecutive years may not, during the five-year
12 [~~two-year~~] period after that fifth [~~seventh~~] year, render a report
13 for the insurer [~~or health maintenance organization~~] or for a
14 subsidiary or affiliate of the insurer [~~or health maintenance~~
15 ~~organization~~] that is engaged in the business of insurance. On
16 application made at least 30 days before the end of the calendar
17 year, the [~~The~~] commissioner may determine that the limitation
18 provided by this subsection does not apply to an accountant for a
19 particular insurer [~~or health maintenance organization~~] if the
20 insurer [~~or health maintenance organization~~] demonstrates to the
21 satisfaction of the commissioner that the limitation's application
22 to the insurer [~~or health maintenance organization~~] would be unfair
23 because of unusual circumstances. In making the determination,
24 the commissioner may consider:

25 (1) the number of partners or individuals the
26 accountant employs, the expertise of the partners or individuals
27 the accountant employs, or the number of the accountant's insurance

1 clients;

2 (2) the premium volume of the insurer [~~or health~~
3 ~~maintenance organization~~]; and

4 (3) the number of jurisdictions in which the insurer
5 [~~or health maintenance organization~~] engages in business.

6 (c-1) On filing its annual statement, an insurer for which
7 the commissioner has approved an exception under Subsection (c)
8 shall file the approval with the states in which it is doing or is
9 authorized to do business and with the National Association of
10 Insurance Commissioners. If a state other than this state accepts
11 electronic filing with the National Association of Insurance
12 Commissioners, the insurer shall file the approval in an electronic
13 format acceptable to the National Association of Insurance
14 Commissioners.

15 (e) In providing services, the accountant shall not
16 function in the role of management, audit the accountant's own
17 work, or serve in an advocacy role for the insurer.

18 (f) The commissioner may not recognize as qualified an
19 accountant, or accept an annual audited financial report that was
20 prepared wholly or partly by an accountant, who provides an insurer
21 at the time of the audit:

22 (1) bookkeeping or other services related to the
23 accounting records or financial statements of the insurer;

24 (2) services related to financial information systems
25 design and implementation;

26 (3) appraisal or valuation services, fairness
27 opinions, or contribution-in-kind reports;

1 (4) actuarially oriented advisory services involving
2 the determination of amounts recorded in the financial statements;

3 (5) internal audit outsourcing services;

4 (6) management or human resources services;

5 (7) broker or dealer, investment adviser, or
6 investment banking services;

7 (8) legal services or other expert services unrelated
8 to the audit; or

9 (9) any other service that the commissioner determines
10 to be inappropriate.

11 (g) Notwithstanding Subsection (f)(4), an accountant may
12 assist an insurer in understanding the methods, assumptions, and
13 inputs used in the determination of amounts recorded in the
14 financial statement if it is reasonable to believe that the
15 advisory service will not be the subject of audit procedures during
16 an audit of the insurer's financial statements. An accountant's
17 actuary may also issue an actuarial opinion or certification on an
18 insurer's reserves if:

19 (1) the accountant or the accountant's actuary has not
20 performed management functions or made any management decisions;

21 (2) the insurer has competent personnel, or engages a
22 third-party actuary, to estimate the reserves for which management
23 takes responsibility; and

24 (3) the accountant's actuary tests the reasonableness
25 of the reserves after the insurer's management has determined the
26 amount of the reserves.

27 (h) An insurer that has direct written and assumed premiums

1 of less than \$100 million in any calendar year may request an
2 exemption from the requirements of Subsection (f) by filing with
3 the commissioner a written statement explaining why the insurer
4 should be exempt. The commissioner may grant the exemption if the
5 commissioner finds that compliance with Subsection (f) would impose
6 an undue financial or organizational hardship on the insurer.

7 (i) An accountant who performs an audit may perform nonaudit
8 services, including tax services, that are not described in
9 Subsection (f) or that do not conflict with Subsection (e) only if
10 the activity is approved in advance by the audit committee in
11 accordance with Subsection (j).

12 (j) The audit committee must approve in advance all auditing
13 services and nonaudit services that an insurer's accountant
14 provides to the insurer. The prior approval requirement is waived
15 with respect to nonaudit services if the insurer is a SOX-compliant
16 entity or a direct or indirect wholly owned subsidiary of a
17 SOX-compliant entity or:

18 (1) the aggregate amount of all nonaudit services
19 provided to the insurer is not more than five percent of the total
20 amount of fees paid by the insurer to its accountant during the
21 fiscal year in which the nonaudit services are provided;

22 (2) the services were not recognized by the insurer at
23 the time of the engagement to be nonaudit services; and

24 (3) the services are promptly brought to the attention
25 of the audit committee and approved before the completion of the
26 audit by the audit committee or by one or more members of the audit
27 committee who are the members of the board of directors to whom the

1 audit committee has delegated authority to grant approvals.

2 (k) The audit committee may delegate to one or more
3 designated members of the audit committee the authority to grant
4 the prior approval required by Subsection (i). The decisions of any
5 member to whom this authority is delegated shall be presented to the
6 full audit committee at each of its scheduled meetings.

7 (l) The commissioner may not recognize an accountant as
8 qualified for a particular insurer if a member of the board, the
9 president, chief executive officer, controller, chief financial
10 officer, chief accounting officer, or any person serving in an
11 equivalent position for the insurer, was employed by the
12 accountant and participated in the audit of that insurer during the
13 one-year period preceding the date on which the most current
14 statutory opinion is due. This subsection applies only to partners
15 and senior managers involved in the audit. An insurer may apply to
16 the commissioner for an exemption from the requirements of this
17 subsection on the basis of unusual circumstances.

18 (m) The insurer shall file, with its annual statement
19 filing, the approval of an exemption granted under Subsection (h)
20 or (l) with the states in which it does or in which it is authorized
21 to do business and the National Association of Insurance
22 Commissioners. If a state other than this state in which the insurer
23 does or in which it is authorized to do business accepts electronic
24 filing, the insurer shall file the approval in an electronic format
25 acceptable to the National Association of Insurance Commissioners.

26 SECTION 12. Section 401.012, Insurance Code, is amended to
27 read as follows:

1 Sec. 401.012. HEARING ON ACCOUNTANT QUALIFICATIONS;
2 REPLACEMENT OF ACCOUNTANT. The commissioner may hold a hearing to
3 determine if an accountant is qualified and independent. If, after
4 considering the evidence presented, the commissioner determines
5 that an accountant is not qualified and independent for purposes of
6 expressing an opinion on the financial statements in an audited
7 financial report filed under this subchapter, the commissioner
8 shall issue an order directing the insurer [~~or health maintenance~~
9 ~~organization~~] to replace the accountant with a qualified and
10 independent accountant.

11 SECTION 13. Section 401.013(a), Insurance Code, is amended
12 to read as follows:

13 (a) The audited financial report required under Section
14 401.004 must be accompanied by a letter provided by the accountant
15 who performed the audit stating:

16 (1) the accountant's general background and
17 experience;

18 (2) the experience of each individual assigned to
19 prepare the audit in auditing insurers [~~or health maintenance~~
20 ~~organizations~~] and whether the individual is an independent
21 certified public accountant; and

22 (3) that the accountant:

23 (A) is properly licensed by an appropriate state
24 licensing authority, is a member in good standing of the American
25 Institute of Certified Public Accountants, and is otherwise
26 qualified under Section 401.011;

27 (B) is independent from the insurer [~~or health~~

1 ~~maintenance organization]~~ and conforms to the standards of the
2 profession contained in the American Institute of Certified Public
3 Accountants Code of Professional Conduct, the statements of that
4 institute, and the rules of professional conduct adopted by the
5 Texas State Board of Public Accountancy, or a similar code;

6 (C) understands that:

7 (i) the audited financial report and the
8 accountant's opinion on the report will be filed in compliance with
9 this subchapter; and

10 (ii) the commissioner will rely on the
11 report and opinion in monitoring and regulating the insurer's [~~or~~
12 ~~health maintenance organization's]~~ financial position; and

13 (D) consents to the requirements of Section
14 401.020 and agrees to make the accountant's work papers available
15 for review by the department or the department's designee.

16 SECTION 14. Sections 401.014(a) and (b), Insurance Code,
17 are amended to read as follows:

18 (a) Not later than December 31 of the calendar year to be
19 covered by an audited financial report required by this subchapter,
20 an insurer [~~or health maintenance organization]~~ must register in
21 writing with the commissioner the name and address of the
22 accountant retained to prepare the report.

23 (b) The insurer [~~or health maintenance organization]~~ must
24 include with the registration a statement signed by the accountant:

25 (1) indicating that the accountant is aware of the
26 requirements of this subchapter and of the rules of the insurance
27 department of the insurer's [~~or health maintenance organization's]~~

1 state of domicile that relate to accounting and financial matters;
2 and

3 (2) affirming that the accountant will express the
4 accountant's opinion on the financial statements in terms of the
5 statements' conformity to the statutory accounting practices
6 prescribed or otherwise permitted by the insurance department
7 described by Subdivision (1) and specifying any exceptions the
8 accountant believes are appropriate.

9 SECTION 15. Sections 401.015(a), (b), and (d), Insurance
10 Code, are amended to read as follows:

11 (a) If an accountant who signed an audited financial report
12 for an insurer [~~or health maintenance organization~~] resigns as
13 accountant for the insurer [~~or health maintenance organization~~] or
14 is dismissed by the insurer [~~or health maintenance organization~~]
15 after the report is filed, the insurer [~~or health maintenance~~
16 ~~organization~~] shall notify the department not later than the fifth
17 business day after the date of the resignation or dismissal.

18 (b) Not later than the 10th business day after the date the
19 insurer [~~or health maintenance organization~~] notifies the
20 department under Subsection (a), the insurer [~~or health maintenance~~
21 ~~organization~~] shall file a written statement with the commissioner
22 advising the commissioner of any disagreements between the
23 accountant and the insurer's [~~or health maintenance organization's~~]
24 personnel responsible for presenting the insurer's [~~or health~~
25 ~~maintenance organization's~~] financial statements that:

26 (1) relate to accounting principles or practices,
27 financial statement disclosure, or auditing scope or procedures;

1 (2) occurred during the 24 months preceding the date
2 of the resignation or dismissal; and

3 (3) would have caused the accountant to note the
4 disagreement in connection with the audited financial report if the
5 disagreement were not resolved to the satisfaction of the
6 accountant.

7 (d) The insurer [~~or health maintenance organization~~] shall
8 file with the statement required by Subsection (b) a letter signed
9 by the accountant stating whether the accountant agrees with the
10 insurer's [~~or health maintenance organization's~~] statement and, if
11 not, the reasons why the accountant does not agree. If the
12 accountant fails to provide the letter, the insurer [~~or health
13 maintenance organization~~] shall file with the commissioner a copy
14 of a written request to the accountant for the letter.

15 SECTION 16. Sections 401.016 and 401.017, Insurance Code,
16 are amended to read as follows:

17 Sec. 401.016. AUDITED COMBINED OR CONSOLIDATED FINANCIAL
18 STATEMENTS. (a) An insurer [~~or health maintenance organization~~]
19 described by Section 401.001 [~~401.001(3) or (4)~~] that is required
20 to file an audited financial report under this subchapter may apply
21 in writing to the commissioner for approval to file audited
22 combined or consolidated financial statements instead of separate
23 audited financial reports if the insurer [~~or health maintenance
24 organization~~]:

25 (1) is part of a group of insurers [~~or health
26 maintenance organizations~~] that uses a pooling arrangement or 100
27 percent reinsurance agreement that affects the solvency and

1 integrity of the insurer's [~~or health maintenance organization's~~]
2 reserves; and

3 (2) cedes all of the insurer's [~~or health maintenance~~
4 ~~organization's~~] direct and assumed business to the pool.

5 (b) An insurer [~~or health maintenance organization~~] must
6 file an application under Subsection (a) not later than December 31
7 of the calendar year for which the audited combined or consolidated
8 financial statements are to be filed.

9 (c) An insurer [~~or health maintenance organization~~] that
10 receives approval from the commissioner under this section shall
11 file a columnar combining or consolidating worksheet for the
12 audited combined or consolidated financial statements that
13 includes:

14 (1) the amounts shown on the audited combined or
15 consolidated financial statements;

16 (2) the amounts for each insurer [~~or health~~
17 ~~maintenance organization~~] stated separately;

18 (3) the noninsurance operations shown on a combined or
19 individual basis;

20 (4) explanations of consolidating and eliminating
21 entries; and

22 (5) a reconciliation of any differences between the
23 amounts shown in the individual insurer [~~or health maintenance~~
24 ~~organization~~] columns of the worksheet and comparable amounts shown
25 on the insurer's [~~or health maintenance organization's~~] annual
26 statements.

27 (d) An insurer [~~or health maintenance organization~~] that

1 does not receive approval from the commissioner to file audited
2 combined or consolidated financial statements for the insurer [~~or~~
3 ~~health maintenance organization~~] and any of the insurer's [~~or~~
4 ~~health maintenance organization's~~] subsidiaries or affiliates
5 shall file a separate audited financial report.

6 Sec. 401.017. NOTICE OF ADVERSE FINANCIAL CONDITION OR
7 MISSTATEMENT OF FINANCIAL CONDITION. (a) An insurer [~~or health~~
8 ~~maintenance organization~~] required to file an audited financial
9 report under this subchapter shall require the insurer's [~~or health~~
10 ~~maintenance organization's~~] accountant to immediately notify the
11 board of directors of the insurer [~~or health maintenance~~
12 ~~organization~~] or the insurer's [~~or health maintenance~~
13 ~~organization's~~] audit committee in writing of any determination by
14 that accountant that:

15 (1) the insurer [~~or health maintenance organization~~]
16 has materially misstated the insurer's [~~or health maintenance~~
17 ~~organization's~~] financial condition as reported to the
18 commissioner as of the balance sheet date being audited; or

19 (2) the insurer [~~or health maintenance organization~~]
20 does not meet the minimum capital and surplus requirements
21 prescribed by this code for the insurer [~~or health maintenance~~
22 ~~organization~~] as of that date.

23 (b) An insurer [~~or health maintenance organization~~] that
24 receives a notice described by Subsection (a) shall:

25 (1) provide to the commissioner a copy of the notice
26 not later than the fifth business day after the date the insurer [~~or~~
27 ~~health maintenance organization~~] receives the notice; and

1 (2) provide to the accountant evidence that the notice
2 was provided to the commissioner.

3 (c) If the accountant does not receive the evidence required
4 by Subsection (b)(2) on or before the fifth business day after the
5 date the accountant notified the insurer [~~or health maintenance~~
6 ~~organization~~] under Subsection (a), the accountant shall file with
7 the commissioner a copy of the accountant's written notice not
8 later than the 10th business day after the date the accountant
9 notified the insurer [~~or health maintenance organization~~].

10 (d) An accountant is not liable to an insurer [~~or health~~
11 ~~maintenance organization~~] or the insurer's [~~or health maintenance~~
12 ~~organization's~~] policyholders, shareholders, officers, employees,
13 directors, creditors, or affiliates for a statement made under this
14 section if the statement was made in good faith to comply with this
15 section.

16 SECTION 17. Section 401.019, Insurance Code, is amended to
17 read as follows:

18 Sec. 401.019. COMMUNICATION OF [REPORT ON SIGNIFICANT
19 DEFICIENCIES IN] INTERNAL CONTROL MATTERS NOTED IN AUDIT. (a) In
20 addition to the audited financial report required by this
21 subchapter, each insurer [~~or health maintenance organization~~]
22 shall provide to the commissioner a written communication prepared
23 by an accountant in accordance [~~report of significant deficiencies~~
24 ~~required and prepared by an accountant in accordance~~] with the
25 Professional Standards of the American Institute of Certified
26 Public Accountants that describes any unremediated material
27 weaknesses in its internal controls over financial reporting noted

1 during the audit.

2 (b) The insurer [~~or health maintenance organization~~] shall
3 annually file with the commissioner the communication [~~report~~]
4 required by this section not later than the 60th day after the date
5 the audited financial report is filed. The communication must
6 contain a description of any unremediated material weaknesses, as
7 defined by Statement on Auditing Standards No. 60, "Communication
8 of Internal Control Related Matters Noted in an Audit," or a
9 successor document, as of the immediately preceding December 31, in
10 the insurer's internal control over financial reporting that was
11 noted by the accountant during the course of the audit of the
12 financial statements. The communication must affirmatively state
13 if unremediated material weaknesses were not noted by the
14 accountant.

15 (c) The insurer [~~or health maintenance organization~~] shall
16 also provide a description of remedial actions taken or proposed to
17 be taken to correct unremediated material weaknesses [~~significant~~
18 ~~deficiencies~~], if the actions are not described in the accountant's
19 communication [~~report~~].

20 (d) [~~(c)~~] The report must follow generally the form for
21 communication of internal control structure matters noted in an
22 audit described in Statement on Auditing Standard (SAS) No. 60, AU
23 Section 325, Professional Standards of the American Institute of
24 Certified Public Accountants.

25 SECTION 18. Sections 401.020(a) and (b), Insurance Code,
26 are amended to read as follows:

27 (a) In this section, "work papers" means the records kept by

1 an accountant of the procedures followed, the tests performed, the
2 information obtained, and the conclusions reached that are
3 pertinent to the accountant's audit of an insurer's [~~or health~~
4 ~~maintenance organization's~~] financial statements. The term
5 includes work programs, analyses, memoranda, letters of
6 confirmation and representation, abstracts of company documents
7 and schedules, and commentaries prepared or obtained by the
8 accountant in the course of auditing the financial statements that
9 support the accountant's opinion.

10 (b) An insurer [~~or health maintenance organization~~]
11 required to file an audited financial report under this subchapter
12 shall require the insurer's [~~or health maintenance organization's~~]
13 accountant to make available for review by the department's
14 examiners the work papers and any record of communications between
15 the accountant and the insurer [~~or health maintenance organization~~]
16 relating to the accountant's audit that were prepared in conducting
17 the audit. The insurer [~~or health maintenance organization~~] shall
18 require that the accountant retain the work papers and records of
19 communications until the earlier of:

20 (1) the date the department files a report on the
21 examination covering the audit period; or

22 (2) the seventh anniversary of the date of the last day
23 of the audit period.

24 SECTION 19. The heading to Section 401.021, Insurance Code,
25 is amended to read as follows:

26 Sec. 401.021. COMMISSIONER-ORDERED AUDIT [~~PENALTY FOR~~
27 ~~FAILURE TO COMPLY~~].

1 SECTION 20. Sections 401.021(a), (b), and (c), Insurance
2 Code, are amended to read as follows:

3 (a) If an insurer [~~or health maintenance organization~~]
4 fails to comply with this subchapter, the commissioner shall order
5 that the insurer's [~~or health maintenance organization's~~] annual
6 audit be performed by a qualified independent certified public
7 accountant.

8 (b) The commissioner shall assess against the insurer [~~or~~
9 ~~health maintenance organization~~] the cost of auditing the insurer's
10 [~~or health maintenance organization's~~] financial statement under
11 this section.

12 (c) The insurer [~~or health maintenance organization~~] shall
13 pay to the commissioner the amount of the assessment not later than
14 the 30th day after the date the commissioner issues the notice of
15 assessment to the insurer [~~or health maintenance organization~~].

16 SECTION 21. Subchapter A, Chapter 401, Insurance Code, is
17 amended by adding Sections 401.022, 401.023, 401.024, and 401.025
18 to read as follows:

19 Sec. 401.022. REQUIREMENTS FOR AUDIT COMMITTEES. (a) This
20 section does not apply to foreign or alien insurers authorized in
21 this state or to an insurer that is a SOX-compliant entity or a
22 direct or indirect wholly owned subsidiary of a SOX-compliant
23 entity.

24 (b) An insurer to which this subchapter applies shall
25 establish an audit committee conforming to the following criteria:

26 (1) an insurer with over \$500 million in direct
27 written and assumed premiums for the preceding calendar year shall

1 establish an audit committee with an independent membership of at
2 least 75 percent; and

3 (2) an insurer with \$300 million to \$500 million in
4 direct written and assumed premiums for the preceding calendar year
5 shall establish an audit committee with an independent membership
6 of at least 50 percent.

7 (c) The commissioner may require the insurer's board to
8 enact improvements to the independence of the audit committee
9 membership if the insurer:

10 (1) is in a risk-based capital action level event;

11 (2) meets one or more of the standards of an insurer
12 considered to be in hazardous financial condition; or

13 (3) otherwise exhibits qualities of a troubled
14 insurer.

15 (d) An insurer with direct written and assumed premiums,
16 excluding premiums reinsured with the Federal Crop Insurance
17 Corporation and the National Flood Insurance Program, of less than
18 \$500 million may apply to the commissioner for a waiver from the
19 requirements of this section based on hardship. The insurer shall
20 file, with its annual statement filing, the approval of a waiver
21 under this subsection with the states in which it does or is
22 authorized to do business and with the National Association of
23 Insurance Commissioners. If a state other than this state accepts
24 electronic filing, the insurer shall file the approval in an
25 electronic format acceptable to the National Association of
26 Insurance Commissioners.

27 (e) In this section, premiums that are assumed from

1 affiliates in the same group of insurers are excluded in
2 determining whether an insurer has less than \$500 million in direct
3 written premiums and assumed premiums.

4 (f) The audit committee is directly responsible for the
5 appointment, compensation, and oversight of the work of any
6 accountant, including the resolution of disagreements between the
7 management of the insurer and the accountant regarding financial
8 reporting, for the purpose of preparing or issuing the audited
9 financial report or related work under this subchapter. Each
10 accountant shall report directly to the audit committee.

11 (g) Each member of the audit committee must be a member of
12 the board of directors of the insurer or a member of the board of
13 directors of an entity elected under Subsection (j) and described
14 under Section 401.001(2-a).

15 (h) To be independent for purposes of this section, a member
16 of the audit committee may not, other than in the person's capacity
17 as a member of the audit committee, the board of directors, or any
18 other board committee, accept any consulting, advisory, or other
19 compensatory fee from the entity or be an affiliated person of the
20 entity or any subsidiary of the entity. To the extent of any
21 conflict with another statute requiring an otherwise
22 nonindependent board member to participate in the audit committee,
23 the other statute prevails and controls, and the member may
24 participate in the audit committee unless the member is an officer
25 or employee of the insurer or an affiliate of the insurer.

26 (i) If a member of the audit committee ceases to be
27 independent for reasons outside the member's reasonable control,

1 the member may remain an audit committee member of the responsible
2 entity if the responsible entity gives notice to the commissioner
3 until the earlier of:

4 (1) the next annual meeting of the responsible entity;
5 or

6 (2) the first anniversary of the occurrence of the
7 event that caused the member to be no longer independent.

8 (j) To exercise the election of the controlling person to
9 designate the audit committee under this subchapter, the ultimate
10 controlling person must provide written notice of the affected
11 insurers to the commissioner. Notice must be made before the
12 issuance of the statutory audit report and must include a
13 description of the basis for the election. The election may be
14 changed through a notice to the commissioner by the insurer, which
15 must include a description of the basis for the change. An election
16 remains in effect until changed by later election.

17 (k) The audit committee shall require the accountant who
18 performs an audit required by this subchapter to report to the audit
19 committee in accordance with the requirements of Statement on
20 Auditing Standards No. 61, "Communication with Audit Committees,"
21 or a successor document, including:

22 (1) all significant accounting policies and material
23 permitted practices;

24 (2) all material alternative treatments of financial
25 information in statutory accounting principles that have been
26 discussed with the insurer's management officials;

27 (3) ramifications of the use of the alternative

1 disclosures and treatments, if applicable, and the treatment
2 preferred by the accountant; and

3 (4) other material written communications between the
4 accountant and the management of the insurer, such as any
5 management letter or schedule of unadjusted differences.

6 (1) If an insurer is a member of an insurance holding
7 company system, the report required by Subsection (k) may be
8 provided to the audit committee on an aggregate basis for insurers
9 in the holding company system if any substantial differences among
10 insurers in the system are identified to the audit committee.

11 Sec. 401.023. PROHIBITED CONDUCT IN CONNECTION WITH
12 PREPARATION OF REQUIRED REPORTS AND DOCUMENTS. (a) A director or
13 officer of an insurer may not, directly or indirectly:

14 (1) make or cause to be made a materially false or
15 misleading statement to an accountant in connection with an audit,
16 review, or communication required by this subchapter; or

17 (2) omit to state, or cause another person to omit to
18 state, any material fact necessary in order to make statements
19 made, in light of the circumstances under which the statements were
20 made, not misleading to an accountant in connection with any audit,
21 review, or communication required under this subchapter.

22 (b) An officer or director of an insurer, or another person
23 acting under the direction of an officer or director of an insurer,
24 may not directly or indirectly coerce, manipulate, mislead, or
25 fraudulently influence an accountant performing an audit under this
26 subchapter if that person knew or should have known that the action,
27 if successful, could result in rendering the insurer's financial

1 statements materially misleading.

2 (c) For purposes of Subsection (b), actions that could
3 result in rendering the insurer's financial statements materially
4 misleading include actions taken at any time with respect to the
5 professional engagement period to coerce, manipulate, mislead, or
6 fraudulently influence an accountant:

7 (1) to issue or reissue a report on an insurer's
8 financial statements that is not warranted and would result in
9 material violations of statutory accounting principles prescribed
10 by the commissioner, generally accepted auditing standards, or
11 other professional or regulatory standards;

12 (2) not to perform an audit, review, or other
13 procedure required by generally accepted auditing standards or
14 other professional standards;

15 (3) not to withdraw an issued report; or

16 (4) not to communicate matters to an insurer's or
17 health maintenance organization's audit committee.

18 Sec. 401.024. MANAGEMENT'S REPORT OF INTERNAL CONTROL OVER
19 FINANCIAL REPORTING. (a) Each insurer required to file an audited
20 financial report under this subchapter that has annual direct
21 written and assumed premiums, excluding premiums reinsured with the
22 Federal Crop Insurance Corporation and the National Flood Insurance
23 Program, of \$500 million or more shall prepare a report of the
24 insurer's or group of insurers' internal control over financial
25 reporting. The report must be filed with the commissioner with the
26 communication described by Section 401.019. The report of internal
27 control over financial reporting shall be as of the immediately

1 preceding December 31.

2 (b) Notwithstanding the premium threshold under Subsection
3 (a), the commissioner may require an insurer to file the
4 management's report of internal control over financial reporting if
5 the insurer is in any risk-based capital level event or meets one or
6 more of the standards of an insurer considered to be in hazardous
7 financial condition as described by Chapter 404.

8 (c) An insurer or a group of insurers may file the insurer's
9 or the insurer's parent's Section 404 report and an addendum if the
10 insurer or group of insurers is:

11 (1) directly subject to Section 404;

12 (2) part of a holding company system whose parent is
13 directly subject to Section 404;

14 (3) not directly subject to Section 404 but is a
15 SOX-compliant entity; or

16 (4) a member of a holding company system whose parent
17 is not directly subject to Section 404 but is a SOX-compliant
18 entity.

19 (d) A Section 404 report described by Subsection (c) must
20 include those internal controls of the insurer or group of insurers
21 that have a material impact on the preparation of the insurer's or
22 group of insurers' audited statutory financial statements,
23 including those items listed in Sections 401.009(a)(3)(B)-(H) and
24 (b). The addendum must be a positive statement by management that
25 there are no material processes with respect to the preparation of
26 the insurer's or group of insurers' audited statutory financial
27 statements, including those items listed in Sections

1 401.009(a)(3)(B)-(H) and (b), excluded from the Section 404 report.
2 If there are internal controls of the insurer or group of insurers
3 that have a material impact on the preparation of the insurer's or
4 group of insurers' audited statutory financial statements and those
5 internal controls are not included in the Section 404 report, the
6 insurer or group of insurers may either file:

7 (1) a report under this section; or

8 (2) the Section 404 report and a report under this
9 section for those internal controls that have a material impact on
10 the preparation of the insurer's or group of insurers' audited
11 statutory financial statements not covered by the Section 404
12 report.

13 (e) The insurer's management report of internal control
14 over financial reporting must include:

15 (1) a statement that management is responsible for
16 establishing and maintaining adequate internal control over
17 financial reporting;

18 (2) a statement that management has established
19 internal control over financial reporting and an opinion concerning
20 whether, to the best of management's knowledge and belief, after
21 diligent inquiry, its internal control over financial reporting is
22 effective to provide reasonable assurance regarding the
23 reliability of financial statements in accordance with statutory
24 accounting principles;

25 (3) a statement that briefly describes the approach or
26 processes by which management evaluates the effectiveness of its
27 internal control over financial reporting;

1 (4) a statement that briefly describes the scope of
2 work that is included and whether any internal controls were
3 excluded;

4 (5) disclosure of any unremediated material
5 weaknesses in the internal control over financial reporting
6 identified by management as of the immediately preceding December
7 31;

8 (6) a statement regarding the inherent limitations of
9 internal control systems; and

10 (7) signatures of the chief executive officer and the
11 chief financial officer or an equivalent position or title.

12 (f) For purposes of Subsection (e)(5), an insurer's
13 management may not conclude that the internal control over
14 financial reporting is effective to provide reasonable assurance
15 regarding the reliability of financial statements in accordance
16 with statutory accounting principles if there is one or more
17 unremediated material weaknesses in its internal control over
18 financial reporting.

19 (g) Management shall document, and make available on
20 financial condition examination, the basis of the opinions required
21 by Subsection (e). Management may base opinions, in part, on its
22 review, monitoring, and testing of internal controls undertaken in
23 the normal course of its activities.

24 (h) Management has discretion as to the nature of the
25 internal control framework used, and the nature and extent of
26 documentation, in order to form its opinion in a cost-effective
27 manner and may include an assembly of or reference to existing

1 documentation.

2 (i) The department shall maintain the confidentiality of
3 the management's report of internal control over financial
4 reporting required by this section and any supporting documentation
5 provided in the course of a financial condition examination.

6 Sec. 401.025. TRANSITION DATES. (a) An insurer or group of
7 insurers whose audit committee as of January 1, 2010, is not subject
8 to the independence requirements of Section 401.022 because the
9 total written and assumed premium is below the threshold under that
10 section, and that later becomes subject to one of the independence
11 requirements because of changes in the amount of written and
12 assumed premium, has one year following the year in which the
13 written and assumed premium exceeds the threshold amount to comply
14 with the independence requirements. An insurer that becomes
15 subject to one of the independence requirements as a result of a
16 business combination must comply with the independence
17 requirements not later than the first anniversary of the date of the
18 acquisition or combination.

19 (b) An insurer or group of insurers that is not required by
20 Section 401.024 to file a report as of January 1, 2010, because the
21 total written premium is below the threshold amount, and that later
22 becomes subject to the reporting requirements, has two years after
23 the year in which the written premium exceeds the threshold amount
24 to file a report. An insurer acquired in a business combination
25 must comply with the reporting requirements not later than the
26 second anniversary of the date of the acquisition or combination.

27 SECTION 22. Section 401.001(3), Insurance Code, is

1 repealed.

2 SECTION 23. (a) Section 401.011(c), Insurance Code, as
3 amended by this Act, takes effect January 1, 2010.

4 (b) Section 401.022, Insurance Code, as added by this Act,
5 takes effect January 1, 2010.

6 (c) Except as provided by Subsections (a) and (b) of this
7 section, Chapter 401, Insurance Code, as amended by this Act, takes
8 effect beginning with the reporting period ending December 31,
9 2010.

10 SECTION 24. Except as otherwise provided by this Act, this
11 Act takes effect September 1, 2009.