

DEPARTMENT OF REGULATORY AGENCIES

Division of Insurance

3 CCR 702-3

PROPOSED REPEALED AND REPROMULGATED REGULATION 3-1-4

CONCERNING ANNUAL AUDITED FINANCIAL REPORTS

Section 1	Authority
Section 2	Scope And Purpose
Section 3	Applicability
Section 4	Definitions
Section 5	Filing and Extensions for Filing of Annual Audited Financial Reports
Section 6	Contents of Annual Audited Financial Report
Section 7	Designation of Independent Certified Public Accountant
Section 8	Qualifications of Independent Certified Public Accountant
Section 9	Consolidated or Combined Audits
Section 10	Scope of Audit and Report of Independent Certified Public Accountant
Section 11	Notification of Adverse Financial Condition
Section 12	Report on Significant Deficiencies in Internal Controls
Section 13	Accountant's Letter of Qualifications
Section 14	Definition, Availability and Maintenance of CPA Workpapers
Section 15	Canadian and British Companies
Section 16	Exemption
Section 17	Severability
Section 18	Enforcement
Section 19	Effective Date
Section 20	History

Section 1 Authority

This regulation is promulgated under the authority of §§10-1-108(7), 10-1-109, 10-1-203, 10-3-109, 10-3-118, 10-3-208, 10-5-117, 10-6-114, 10-6-129, 10-14-505, 10-14-602, 10-16-109, 10-16-111 and 8-45-121 C.R.S.

Section 2 Scope And Purpose

- A. The purpose of this regulation is to improve the Division's surveillance of the financial condition of companies by requiring an annual audit by independent certified public accountants of the financial statements reporting the financial position and the results of operations of companies.
- B. This regulation shall not prohibit, preclude or in any way limit the Commissioner from ordering or conducting or performing examinations of companies under the rules and regulations of the Division and the practices and procedures of the Division.

Section 3 Applicability

- A. Every company, as defined in Section 4 shall be subject to this regulation.
- B. Every insurer, as defined in Section 4 having direct premiums written in this state of less than \$1,000,000 in any calendar year and less than 1,000 policyholders or certificate holders of directly written policies nationwide at the end of the calendar year shall be exempt from this regulation for the year (unless the Commissioner makes a specific finding that compliance is

necessary for the Commissioner to carry out statutory responsibilities), except that insurers having assumed premiums pursuant to contracts and/or treaties of reinsurance of \$1,000,000 or more will not be so exempt.

- C. Foreign or alien companies filing audited financial reports in another state, pursuant to such other state's requirement of audited financial reports that has been found by the Commissioner to be substantially similar to the requirements herein, are exempt from this regulation if:
1. A copy of the Audited Financial Report, Report on Significant Deficiencies in Internal Controls, and the Accountant's Letter of Qualifications that are filed with the other state are filed with the Commissioner in accordance with the filing dates specified in Sections 5, 12 and 13, respectively (Canadian companies may submit accountants' reports as filed with the Canadian Dominion Department of Insurance).
 2. A copy of any Notification of Adverse Financial Condition Report filed with the other state is filed with the Commissioner within the time specified in Section 11.

Section 4 Definitions

The following terms used in this regulation shall have the following meanings:

- A. "Accountant" or "independent certified public accountant" means an independent certified public accountant or accounting firm in good standing with the American Institute of Certified Public Accountants and in all states in which he or she is licensed to practice; for Canadian and British companies, it means a Canadian-chartered or British-chartered accountant.
- B. "Audited financial report" means and includes those items specified in Section 6 of this regulation.
- C. "Commissioner" means the Commissioner of Insurance for the State of Colorado.
- D. "Company" means an insurer, captive insurance company, health maintenance organization or Pinnacol Assurance.
- E. "Division" means the Colorado Division of Insurance.
- F. "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 company or its representatives.
- G. "Insurer" means a licensed insurance company, authorized surplus lines insurance company, authorized nonadmitted reinsurer, nonprofit hospital, medical-surgical, and health service corporation or fraternal benefit society.

Section 5 Filing And Extensions For Filing Of Annual Audited Financial Reports

- A. All companies shall have an annual audit by an independent certified public accountant and shall file an audited financial report with the Commissioner on or before June 1 for the year ended December 31 immediately preceding. The Commissioner may require a company to file an audited financial report earlier than June 1 with ninety (90) days advance notice to the company.
- B. Extensions of the June 1 filing date may be granted by the Commissioner for thirty (30) day periods upon a showing by the company and its independent certified public accountant of the reasons for requesting an extension and determination by the Commissioner of good cause for an extension. The request for extension must be submitted in writing not less than ten (10) days

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

Section 6 Contents Of Annual Audited Financial Report

- A. The annual audited financial report shall report the financial position of the company as of the end of the most recent calendar year and the results of its operations, cash flows and changes in capital and surplus for the year then ended in conformity with statutory accounting practices prescribed, or otherwise permitted, by the Department of Insurance of the state of domicile.

- B. The annual audited financial report shall include the following:
 - 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 required by the appropriate National Association of Insurance Commissioners Annual Statement Instructions and the National Association of Insurance Commissioners Accounting Practices and Procedures Manual. The notes shall include a reconciliation of differences, if any, between the audited statutory financial statements and the annual statement filed pursuant to §§10-3-109, 10-3-208, 10-5-110, 10-6-114, 10-14-602, 10-16-111 or 8-45-117, C.R.S., with a written description of the nature of these differences.
 - 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 statement of the company filed with the Commissioner, and the financial statement shall be comparative, presenting the amounts as of December 31 of the current year and the amounts as of the immediately preceding December 31. (However, in the first year in which a company is required to file an audited financial report, the comparative data may be omitted).

Section 7 Designation Of Independent Certified Public Accountants

- A. Each company required by this regulation to file an annual audited financial report must within sixty (60) days after becoming subject to the requirement, register with the Commissioner in writing the name and address of the independent certified public accountant or accounting firm (generally referred to in this regulation as the "accountant") retained to conduct the annual audit set forth in this regulation.

- B. The company shall obtain a letter from the accountant, and file a copy with the Commissioner stating that the accountant is aware of the provisions of the insurance code and the regulations of the insurance department of the state of domicile that relate to accounting and financial matters and affirming that the accountant will express his or her opinion on the financial statements in terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by that insurance department, specifying such exceptions as he or she may believe appropriate.

- C. If an accountant who was the accountant for the immediately preceding filed audited financial report is dismissed or resigns, the company shall within five (5) business days notify the Commissioner of this event. The company shall also furnish the Commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty-four (24) months preceding such event 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. The disagreements required to be reported in response to this section include both those resolved to the former accountant's satisfaction and those not resolved to the former accountant's satisfaction. Disagreements contemplated by this section are those that occur at the decision-making level, i.e., between personnel of the company responsible for presentation of its financial statements and personnel of the accounting firm responsible for rendering its report. The company shall also in writing request the former accountant to furnish a letter addressed to the company stating whether the accountant agrees with the statements contained in the company's letter and, if not, stating the reasons for which he or she does not agree; and the company shall furnish the responsive letter from the former accountant to the Commissioner together with its own.

Section 8 Qualifications Of Independent Certified Public Accountant

- A. The Commissioner shall not recognize a person or firm as a qualified independent certified public accountant if the person or firm:
1. Is not in good standing with the American Institute of Certified Public Accountants and in all states in which the accountant is licensed to practice, or, for a Canadian or British company, that is not a chartered accountant; or
 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 company.
- B. Except as otherwise provided in this regulation, the Commissioner shall recognize an independent certified public accountant as qualified as long as he or she conforms to the standards of his or her profession. Accountants should be guided by the relevant professional standards promulgated by the American Institute of Certified Public Accountants, and the Rules, Regulations, Code of Ethics and Rules of Professional Conduct of the Colorado Board of Public Accountancy.
- C. A qualified independent certified public accountant may enter into an agreement with a company to have disputes relating to an audit resolved by mediation or arbitration. However, in the event of a delinquency proceeding commenced against the company under § 10-3-401, et seq., C.R.S., the mediation or arbitration provisions shall operate at the option of the statutory successor.
- D. No partner or other person responsible for rendering a report may act in that capacity for more than five (5) consecutive years. Following a period of service 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 two (2) years. A company may make application to the Commissioner for relief from the above rotation requirement on the basis of unusual circumstances. The Commissioner may consider the following factors in determining if the relief should be granted:
1. Number of partners, expertise of the partners or the number of insurance clients in the currently registered firm;

2. Premium volume of the company; or
 3. Number of jurisdictions in which the company transacts business.
- E. The Commissioner shall not recognize as a qualified independent certified public accountant, nor accept an annual audited financial report, prepared in whole or in part by, a natural person who:
1. Has been convicted of fraud, bribery, a violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Sections 1961 to 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 regulation; 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 regulation,
- F. The Commissioner 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 regulation and require the company to replace the accountant with another whose relationship with the company is qualified within the meaning of this regulation.

Section 9 Consolidated Or Combined Audits

An insurer may make written application to the Commissioner 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 that utilizes a pooling or one hundred percent (100%) reinsurance agreement that affects the solvency and integrity of the insurer's reserves and the insurer cedes all of its direct and assumed business to the pool. In such cases, a columnar consolidating or combining worksheet shall be filed with the report, as follows:

- A. Amounts shown on the consolidated or combined audited financial report shall be shown on the worksheet;
- B. Amounts for each insurer subject to this section shall be stated separately;
- C. Noninsurance operations may be shown on the worksheet on a combined or individual basis;
- D. Explanations of consolidating and eliminating entries shall be included: and
- E. 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 annual statements of the insurers.

Section 10 Scope Of Audit And Report Of Independent Certified Public Accountant

Financial statements furnished pursuant to Section 6 shall be audited by an independent certified public accountant. The audit of the company's financial statements shall be conducted in accordance with generally accepted auditing standards. Consideration shall be given to the procedures illustrated in the Financial Condition Examiners Handbook promulgated by the

National Association of Insurance Commissioners, as the independent certified public accountant deems necessary.

Section 11 Notification Of Adverse Financial Condition

- A. The company required to furnish the annual audited financial report shall require the independent certified public accountant to report, in writing, within five (5) business days to the board of directors or its audit committee any determination by the independent certified public accountant that the company has materially misstated its financial condition as reported to the Commissioner as of the balance sheet date currently under audit or that the company does not meet the minimum capital and surplus requirement of the Colorado insurance code as of that date. A company that has received a report pursuant to this paragraph shall forward a copy of the report to the Commissioner within five (5) business days of receipt of the report and shall provide the independent certified public accountant making the report with evidence of the report being furnished to the Commissioner. If the independent certified public accountant fails to receive the evidence within the required five (5) business day period, the independent certified public accountant shall furnish to the Commissioner a copy of its report within the next five (5) business days.
- B. No independent public accountant shall be liable in any manner to any person for any statement made in connection with the above paragraph if the statement is made in good faith in compliance with Subsection A.
- C. If the accountant, subsequent to the date of the audited financial report filed pursuant to this regulation, becomes aware of facts that might have affected his or her report, the Commissioner notes the obligation of the accountant to take such action as prescribed in Volume 1, Section AU 561 of the Professional Standards of the American Institute of Certified Public Accountants (Copyright © 2004, American Institute of Certified Public Accountants, Inc.). This rule does not include later amendments to or editions of the incorporated American Institute of Certified Public Accountants' materials.

Section 12 Report On Significant Deficiencies In Internal Controls

In addition to the annual audited financial statements, each company shall furnish the Commissioner with a written report prepared by the accountant describing significant deficiencies in the company's internal control structure noted by the accountant during the audit. SAS No. 60, Communication of Internal Control Structure Matters Noted in an Audit (AU Section 325 of the Professional Standards of the American Institute of Certified Public Accountants)(Copyright © 2005, American Institute of Certified Public Accountants, Inc.) requires an accountant to communicate significant deficiencies (known as "reportable conditions") noted during a financial statement audit to the appropriate parties within an entity. No report should be issued if the accountant does not identify significant deficiencies. If significant deficiencies are noted, the written report shall be filed annually by the company with the Division within sixty (60) days after the filing of the annual audited financial statements. The company is required to provide a description of remedial actions taken or proposed to correct significant deficiencies, if the actions are not described in the accountant's report. This rule does not include later amendments to or editions of the incorporated American Institute of Certified Public Accountants' materials.

Section 13 Accountant's Letter Of Qualifications

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

- A. That the accountant is independent with respect to the company. Accountants' determination of independence should be guided by the relevant ethical standards promulgated by the American

Institute of Certified Public Accountants, and the Rules, Regulations, Code of Ethics and Rules of Professional Conduct of the Colorado Board of Public Accountancy;

- B. The background and experience in general, and the experience in audits of companies of the staff assigned to the engagement and whether each is an independent certified public accountant. Nothing within this regulation shall be construed as prohibiting the accountant from utilizing such staff as he or she deems appropriate where use is consistent with the standards prescribed by generally accepted auditing standards;
- C. That the accountant understands the annual audited financial report and his opinion thereon will be filed in compliance with this regulation and that the Commissioner will be relying on this information in the monitoring and regulation of the financial position of companies;
- D. That the accountant consents to the requirements of Section 14 of this regulation and that the accountant consents and agrees to make available for review by the Commissioner, or the Commissioner's designee or appointed agent, the workpapers, as defined in Section 14;
- E. A representation that the accountant is properly licensed by an appropriate state licensing authority and is a member in good standing in the American Institute of Certified Public Accountants; and
- F. A representation that the accountant is in compliance with the requirements of Section 8 of this regulation.

Section 14 Definition, Availability and Maintenance of CPA Workpapers

- A. Workpapers are the records kept by the independent certified public accountant of the procedures followed, the tests performed, the information obtained, and the conclusions reached pertinent to the accountant's audit of the financial statements of a company. Workpapers, accordingly, may include audit planning documentation, work programs, analyses, memoranda, letters of confirmation and representation, abstracts of company documents and schedules or commentaries prepared or obtained by the independent certified public accountant in the course of his or her audit of the financial statements of a company and which support the accountant's opinion.
- B. Every company required to file an audited financial report pursuant to this regulation, shall require the accountant to make available for review by Division examiners, all workpapers prepared in the conduct of the accountant's audit and any communications related to the audit between the accountant and the company, at the offices of the company, at the Division or at any other reasonable place designated by the Commissioner. The company shall require that the accountant retain the audit workpapers and communications until the Division has filed a Report of Examination covering the period of the audit but no longer than seven (7) years from the date of the audit report.
- C. In the conduct of the aforementioned periodic review by the Division examiners, it shall be agreed that photocopies of pertinent audit workpapers may be made and retained by the Division. Such reviews by the Division examiners shall be considered investigations and all working papers and communications obtained during the course of such investigations shall be afforded the same confidentiality as other audit workpapers generated by the Division.
- D. Notwithstanding the above, audit reports and workpapers are additionally subject to, and protected by, the provisions of Article 2 of Title 12, C.R.S. Companies, which are subject to oversight by both the Division and the State Auditor's Office, are also governed by the provisions of Article 3 of Title 2, C.R.S.

Section 15 Canadian and British Companies

- A. In the case of Canadian and British insurers, the annual 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.
- B. For such insurers, the letter required in Section 7 shall state that the accountant is aware of the requirements relating to the annual audited statement filed with the Commissioner pursuant to Section 5 and shall affirm that the opinion expressed is in conformity with those requirements.

Section 16 Exemption

Upon written application of any company, the Commissioner may consider granting an exemption from compliance with this regulation. The Commissioner shall consider, in addition to any other pertinent facts and information about operations and financial condition, whether compliance with this regulation would constitute a financial hardship to the company. A request for exemption must be made for each calendar year for which such exemption is sought. Application for exemption must be received on or before December 31 of the year for which such exemption is sought.

Section 17 Severability

If any section or portion of a section of this regulation or its applicability to any person or circumstance is held invalid by a court, the remainder of the regulation or the applicability of the provision to other persons or circumstances shall not be affected.

Section 18 Enforcement

Noncompliance with this Regulation may result, after proper notice and hearing, in the imposition of any of the sanctions made available in the Colorado statutes pertaining to the business of insurance or other laws which include the imposition of fines, issuance of cease and desist orders, and/or suspensions or revocation of license. Among others, the penalties provided for in §10-3-109(3), C.R.S. may be applied.

Section 19 Effective Date

This repealed and repromulgated regulation shall become effective January 30, 2007.

Section 20 History

This regulation was originally effective December 31, 1990.

Amended, January 31, 1994.

Amended, effective April 1, 2001.

Repealed and repromulgated January 30, 2007.