

CHAPTER 7. CORPORATE AND FINANCIAL REGULATION
SUBCHAPTER A. EXAMINATION AND FINANCIAL ANALYSIS
28 TAC §7.18 and §7.85

1. INTRODUCTION. The Texas Department of Insurance adopts amendments to 28 TAC §7.18 and §7.85, concerning the National Association of Insurance Commissioners Accounting Practices and Procedures Manual. The amendments to §7.18 establish a priority of sources for the commissioner of insurance, insurers, and health maintenance organizations (HMOs) to use when determining the proper accounting treatment for insurance or health plan transactions that will continue from year to year without further action of the commissioner. The amendments to §7.85 make nonsubstantive updates to Insurance Code and Administrative Code citations. The amendments are adopted with changes to the proposed text published in the September 19, 2014, issue of the *Texas Register* (39 TexReg 7555). TDI has changed the reference “generally accepted accounting practices” to “generally accepted accounting principles” and the word “department” to “TDI.”

Consistent with prior versions of §7.18, the sources are: (1) Texas statutes; (2) TDI rules; (3) directives, instructions, and orders of the commissioner; (4) except as provided in the exceptions and modifications set out in subsections (c) and (d) of this section, the National Association of Insurance Commissioners’ (NAIC) *Accounting Practices and Procedures Manual* (manual); (5) other NAIC handbooks, manuals, and instructions adopted by TDI; and (6) Generally Accepted Accounting Principles.

Section 7.18 establishes these sources for use on a continuous basis without the necessity of further action by the commissioner, including amendments to this section. TDI considers the adoption by reference process unnecessary because, under existing rules and this adoption, the commissioner reserves all authority and discretion to resolve any issues in Texas concerning the proper accounting treatment for an insurance or health plan transaction. The sources of information that the commissioner will use to make these determinations does not change. This adoption states the priority of the sources the commissioner will use to make the determinations and provides insurers and HMOs (collectively referred to as “carriers”) with that information to timely and accurately record their transactions and to complete and file their reports.

In establishing these sources, the commissioner has not delegated authority to others. Except for statute, each source is subject to the commissioner’s jurisdiction to amend the guidance on how to properly record business transactions for accurate statutory reporting and for preparing all financial statements filed with TDI. Even without direct amendments in this section, as shown in §7.18(c) and (d), the authority to establish sources and determine their effect is vested in statute or the commissioner.

The procedure for amending a source will depend on the circumstance, provision involved, and timing. As addressed in §7.18(a)(2) and (3), the commissioner may propose rules or issue orders. Under existing law, interested persons may petition the commissioner for rules or otherwise bring to the

commissioner's attention the need for action to address a problem, including requesting a permitted practice deviation under §7.18(f).

The manual incorporates the statements of statutory accounting principles (SSAPs) that are developed by regulators with input from the insurance industry. The SSAPs provide a national standard for carriers to determine how to properly record business transactions for statutory reporting. The SSAPs are adopted by regulators through a deliberative process, which includes a series of open meetings that offer the public the opportunity to comment on the proposed SSAPs. The manual is published annually by the NAIC to reflect any changes to the SSAPs made through this process.

Like the other sources of information listed in §7.18(a), TDI uses the manual, including its appendices, as the source of statutory accounting principles and actuarial guidelines when analyzing financial reports, conducting statutory examinations, and determining rehabilitations of carriers licensed in Texas, unless a TDI rule or other state law provides otherwise. Based on comments, TDI has changed the existing reference to "generally accepted accounting practices" to "generally accepted accounting principles."

The current manual is the NAIC's 2014 *Accounting Practices and Procedures Manual*. The 2014 manual is the current source of SSAP information for the commissioner, insurers, and HMOs to use when determining the proper accounting treatment for an insurance or health plan transaction for filings made

and examinations dated on or after December 31, 2013, pending its subsequent amendment or the adoption of a new manual.

Under the adopted section, TDI will not specifically adopt the manual or changes subsequent to that manual. As directed by §7.18(a) and (b), the commissioner and carriers will use the current manual and subsequent manuals and changes as the source of SSAP information for determining the proper accounting treatment for an insurance or health plan transaction for filings and examinations. This will allow insurers to file reports in Texas using requirements that are consistent with those used in other states that apply the manual.

The manual is available for purchase from the NAIC. The current manual is available for inspection in the Financial Regulation Division of the Texas Department of Insurance, William P. Hobby Jr. State Office Building, Tower Number III, Third Floor, 333 Guadalupe, Austin, Texas. TDI will make a copy of the current manual and any substantive and nonsubstantive amendments that have been adopted since the publication of the last manual available for public inspection.

Section 7.85 sets out rules governing the information to be included in the audited financial report under Insurance Code §401.009(a)(3)(H). The amendments to §7.85 make nonsubstantive updates to references to §7.18 and statutory citations. TDI has also made nonsubstantive changes in the text to reflect TDI style guidelines in both §7.18 and §7.85.

3. SUMMARY OF COMMENTS AND AGENCY RESPONSE.

Comment: A commenter suggests that the reference in §7.18(a) to “generally accepted accounting practices” should refer to “U.S. generally accepted accounting principles,” because that is the proper reference.

Agency Response: TDI agrees that the reference is incorrect and has changed the reference in existing text from “generally accepted accounting practices” to “generally accepted accounting principles.” The term “practices” appeared as an unmarked change to the existing text term “principles” in amendments to §7.18 proposed in the January 2, 2004, issue of the *Texas Register* (29 TexReg 49) and adopted in the March 12, 2004, issue of the *Texas Register* (29 TexReg 2647). TDI has not received prior comments on the term “practices” in this section. TDI believes the reference should be returned to “generally accepted accounting principles” as originally adopted.

4. NAMES OF THOSE COMMENTING ON THE PROPOSAL.

For with changes: Molina Healthcare.

5. STATUTORY AUTHORITY. TDI adopts the amendments to §7.18 under Insurance Code Chapters 32, 401, 404, 421, 425, 426, 441, 802, 823, 841, 843, 861, and 862, and §36.001. TDI adopts the amendments to §7.85 under Insurance Code §401.009 and §36.001.

Section 32.041 requires TDI to furnish the required financial statement forms to the companies. Section 401.051 and §401.056 mandate that TDI examine the financial condition of each carrier organized under the laws of Texas or authorized to transact the business of insurance in Texas, and to adopt by rule procedures for the filing and adoption of examination reports. Section 404.005(a)(2) authorizes the commissioner to establish standards for evaluating the financial condition of an insurer.

Section 421.001(c) requires the commissioner to adopt each current formula recommended by the NAIC for establishing reserves for each line of insurance. Section 425.162 authorizes the commissioner to adopt rules, minimum standards, or limitations that are fair and reasonable as appropriate to supplement and implement Insurance Code Chapter 425, Subchapter C. Section 426.002 provides that reserves required by §426.001 must be computed in accord with any rules adopted by the commissioner to adequately protect insureds, secure the solvency of the workers' compensation insurance company, and prevent unreasonably large reserves.

Section 441.005 authorizes the commissioner to adopt reasonable rules as necessary to implement and supplement Insurance Code Chapter 441. Section 802.001 authorizes the commissioner to obtain an accurate indication of the company's condition and method of transacting business, as necessary, to change the form of any annual statement required to be filed by any kind of insurance

company. Section 823.012 authorizes the commissioner to issue rules and orders necessary to implement the provisions of Insurance Code Chapter 823.

Section 843.151 authorizes the commissioner to promulgate rules that are necessary and proper to implement the provisions of Insurance Code Chapter 843. Section 843.155 requires HMOs to file annual reports with the commissioner, including a financial statement of the HMO, certified by an independent public accountant.

Section 401.009 authorizes the commissioner to adopt rules governing the information to be included in the audited financial report under Insurance Code §401.009(a)(3)(H). Section 36.001 provides that the commissioner may adopt any rules necessary and appropriate to implement the powers and duties of TDI under the Insurance Code and other laws of this state.

6. CROSS REFERENCE TO STATUTE. The adopted amendments to §7.18 affect the following statutes: Insurance Code §§32.041, 401.051, 401.056, 404.005(a)(2), 421.001(c), 425.162, 426.002, 441.005, 802.001, 823.012, 843.151, and 843.155.

The adopted amendments to §7.85 affect Insurance Code §401.009.

7. TEXT.

§7.18. National Association of Insurance Commissioners Accounting Practices and Procedures Manual.

(a) The commissioner reserves all authority and discretion to resolve any issues in Texas concerning the proper accounting treatment for an insurance or health plan transaction. When determining the proper accounting treatment for an insurance or health plan transaction, the commissioner, insurers, and health maintenance organizations will refer to the sources in paragraphs (1) - (6) of this subsection in the respective order of priority listed for guidance on how to properly record business transactions for the purpose of accurate statutory reporting and for preparing all financial statements filed with TDI. The sources in paragraphs (1) - (3) of this subsection preempt any contrary provisions in the National Association of Insurance Commissioners' (NAIC) *Accounting Practices and Procedures Manual* (manual).

- (1) Texas statutes;
- (2) TDI rules;
- (3) directives, instructions, and orders of the commissioner;
- (4) except as provided in the exceptions, modifications, and exemptions set forth in subsections (c) and (d) of this section, the manual;
- (5) other NAIC handbooks, manuals, and instructions adopted by TDI; and
- (6) Generally Accepted Accounting Principles.

(b) The manual described in subsection (a)(4) of this section includes the manual as amended from time to time, and all the substantive and nonsubstantive changes to the manual that have been adopted since its last publication. TDI will

maintain a copy of the current manual and all substantive and nonsubstantive changes that have been adopted since the last publication for public inspection at its offices.

(c) The commissioner adopts the following exceptions and modifications to the manual:

(1) Settlement requirements for intercompany transactions are subject to the accounting treatment in Statement of Statutory Accounting Principles (SSAP) No. 25 (previously SSAP No. 96 located in Appendix H), except that amounts owed to the reporting entity must be settled by the due date in accord with the written agreement and the requirements of §7.204 of this title.

Intercompany balances must be settled within 90 days of the period for which the amounts are being billed or the balances will be nonadmitted.

(2) Electronic machines, constituting a data processing system or systems, and operating systems software used in connection with the business of an insurance company acquired after December 31, 2000, may be admitted assets as permitted by Insurance Code §§841.004, 861.255, 862.001, and any other applicable law and must be amortized as provided by the manual.

(3) Furniture, labor-saving devices, machines, and all other office equipment may be admitted as assets as permitted by Insurance Code §§841.004, 861.255, 862.001, and any other applicable law and, for property acquired after December 31, 2000, depreciated in full over a period not to exceed five years.

(d) A farm mutual insurance company, statewide mutual assessment company, local mutual aid association, or mutual burial association that has less than \$6 million in annual direct written premiums is not required to comply with the manual.

(e) Preemptions.

(1) Insurance Code provisions preempting any contrary provisions in the manual include: §§2551.251 - 2551.261 and 3503.202.

(2) TDI rules preempting any contrary provisions in the manual include: §§3.1501 - 3.1505, 3.1601 - 3.1608, 3.4505(f), 3.6101, 3.6102, 3.7001 - 3.7009, 3.9101 - 3.9106, 3.9401 - 3.9404, 7.7, 7.85, and 11.803 of this title.

(f) In the event a domestic insurer or health maintenance organization desires to deviate from the accounting guidance in a Texas statute or any applicable regulation, the insurer or health maintenance organization must file a written request for a permitted accounting practice and obtain approval prior to using the accounting deviation in a financial statement. The filing must be sent to: Deputy Commissioner, Financial Regulation Division, Texas Department of Insurance, Mail Code 305-2A, P.O. Box 149104, Austin, Texas 78714-9104, at least 30 days before filing the financial statement that would be affected by the deviated accounting practice. A domestic insurer or health maintenance organization must not use a deviated accounting practice without TDI's prior approval.

(g) This section must not be construed to either broaden or restrict the authority provided under the Insurance Code to insurers or health maintenance organizations.

§7.85. Audited Financial Reports

(a) Definitions. The following words and terms, when used in this section, will have the following meanings, unless the context clearly indicates otherwise.

(1) Accountant--An independent certified public accountant or accounting firm that meets the requirements of Insurance Code §401.014.

(2) Audited Financial Report--The annual audit report required by Insurance Code Chapter 401, Subchapter A.

(3) Commissioner--The commissioner of insurance.

(4) TDI--The Texas Department of Insurance.

(5) Examiner--Staff appointed by the commissioner under Insurance Code Chapter 401, Subchapter C.

(6) GAAS--Generally Accepted Auditing Standards. The standards adopted by the American Institute of Certified Public Accountants or Public Company Accounting Oversight Board to conduct an audit and to ensure the quality of the performance by accountants who are engaged in an audit of financial statements.

(7) Material--As defined in the NAIC's *Accounting Practices and Procedures Manual* under §7.18 of this title.

(8) NAIC--The National Association of Insurance Commissioners.

(9) Statutory Examination--An examination performed by TDI's examiners or other persons or firms retained by TDI specifically for examination of insurers, corporations, or associations.

(10) Work Papers--The records kept by the accountant supporting that accountant's audit opinion, including the audit records and the accountant's audit planning records; and any record of communications related to the audit between the accountant and the insurer under Insurance Code §401.020.

(b) Priority of Accounting Guidance. The priority for determining accounting standards is set out in §7.18 of this title.

(c) Applicability. This section applies only to audited financial reports with audit dates as of December 31, 1995, or later. A foreign or alien insurer may be exempt from this rule if the foreign or alien insurer files an audited financial report in another state and the requirements for that state's audited financial reports are determined by the commissioner under Insurance Code §401.007 to be substantially similar to the requirements in Insurance Code Chapter 401. A foreign or alien insurer is exempt from this rule if the foreign or alien insurer files an audited financial report in another state and the requirements for that state's audited financial reports have already been determined by the commissioner under Insurance Code §401.007 to be substantially similar to the requirements in Insurance Code Chapter 401.

(d) Purpose. Insurance Code Chapter 401 requires audited financial reports to be prepared, and that statutory examinations are periodically conducted under the Insurance Code. To improve coordination between the audited financial reports and statutory examinations, and to promote the utilization of work papers to the fullest extent during the conduct of statutory examinations, certain minimum standards, guidelines, and procedures must be incorporated by the accountant during the preparation of the work papers and the audited financial report. The purpose of this section is to establish those requirements.

(e) Conduct of audit. The annual audit required by Insurance Code Chapter 401 must be conducted in accord with GAAS. It is not TDI's intent to expand audit testing beyond the requirements of GAAS. The accountant conducting the audit must consider the procedures and conventions set out in paragraphs (1) - (4) of this subsection, as follows:

(1) audit procedures and format contained in the NAIC Examiners Handbook;

(2) accounting treatments for the particular line(s) of insurance contained in §7.18 of this title and the NAIC Annual Statement Instructions adopted by the commissioner under §7.68 of this title;

(3) valuation procedures contained in the NAIC Investment Analysis Office's *Purposes and Procedures Manual* and §7.18 of this title; and

(4) any orders of the commissioner issued to a particular company.

(f) Contents of audited financial reports. In addition to the contents specified in Insurance Code §401.009, audited financial reports must contain the statements and reports set out in paragraphs (1) - (3) of this subsection.

(1) Audit procedures and format contained in the NAIC Examiners Handbook.

(2) The balance sheet, statement of gain or loss from operations, statement of changes in capital and surplus, and statement of cash flow prepared in accord with the Texas Administrative Code, including the NAIC Annual Statement Instructions adopted by the commissioner in §7.68 of this title.

(3) In addition to the items that must be recorded in the notes to the financial statements under Insurance Code §401.009(b), the notes must include:

(A) any exceptions to compliance with the financial, investment, and holding company provisions of the Insurance Code or the Texas Administrative Code noted during the audit;

(B) a schedule and explanation of material nonadmitted assets;

(C) any and all items required by the NAIC Annual Statement Instructions and the NAIC *Accounting Practices and Procedures Manual* under §7.68 and §7.18 of this title; and

(D) a reconciliation of any differences between the audited statutory financial statements and the Annual Statement filed with TDI, with a written description of the nature of the differences.

(g) Contents of work papers.

(1) For those items subjected to detailed tests by the accountant during the course of the audit, the work papers must contain a notation of whether any material exceptions exist for each of the items set out in subparagraphs (A) and (B) of this paragraph.

(A) For invested assets:

(i) compliance as an authorized investment has been determined and does not exceed statutory limitations;

(ii) ownership and possession have been verified; and

(iii) securities are valued in accord with the instructions of the NAIC Investment Analysis Office's *Purposes and Procedures Manual* and §7.18 of this title.

(B) For assets other than invested assets:

(i) the assets are admitted in accord with the appropriate provision of the Insurance Code or Texas Administrative Code; and

(ii) the assets are valued in accord with the Texas Administrative Code and §7.18 of this title.

(2) If the regulated entity subject to the audit has any material reinsurance agreement or agreements, the work papers must contain an outline addressing the items set out in subparagraphs (A) - (E) of this paragraph as follows:

(A) a summary of the insurer's overall reinsurance program;

(B) an explanation of relevant provisions by which liabilities are transferred to the reinsurer and any contingency provisions by which the reinsurer can cause the ceding insurer to reassume liabilities previously transferred to the reinsurer;

(C) an explanation about assets held in trust, depositories, or letters of credit by which any reserve liabilities are collateralized;

(D) a verification of any material reinsurance balance ceded or assumed; and

(E) an explanation of amounts recoverable from unlicensed reinsurers that are not collateralized, or disputed reinsurance recoverables.

(3) The work papers of any audited entity must contain:

(A) any letters from the accountant to management commenting on or explaining internal management operating procedures;

(B) computer-generated work papers;

(C) audit program;

(D) reports prepared by outside consultants;

(E) for policy liabilities, a note that reserves are established in accord with policy and statutory provisions, and that required payments were made under any contract provisions;

(F) for all other liabilities, a note that all material liabilities of the company have been properly recorded; and

(G) internal control work papers.

(4) The work papers of any audited entity must contain a notation that the accountant has determined that the entity has:

(A) met the filing requirements in Insurance Code Chapter 823 and the Texas Administrative Code, including the requirements that all shareholder dividends have been reported to TDI within two business days after declaration and at least 10 days prior to payment as required under Insurance Code §823.053; and that all other dividends have been declared and paid in accord with the applicable provisions of the Insurance Code and the Texas Administrative Code, including Chapter 403, Chapter 1112, §841.253, and §884.253; and

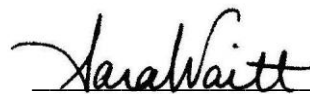
(B) maintained unencumbered assets in an amount at least equal to reserve liabilities as required under Insurance Code Chapter 422.

(h) Accessibility of work papers. The accountant must provide all work papers to the examiner, whether during or after the preparation of the audited financial report. The examiner may obtain, if necessary, photocopies of work papers, as provided by Insurance Code §401.020(c), so as not to burden the accountant if a statutory examination is occurring at the same time as an annual audit. Information obtained under this section is subject to the confidentiality standards imposed by Insurance Code §§401.020(c), 401.057, 401.105, 401.106, and 823.011.

(i) Sanction. Failure to comply with this section may result in the commissioner initiating action under Insurance Code §401.012 and Chapter 82.

8. CERTIFICATION. This agency certifies that legal counsel has reviewed the adopted sections and finds them to be a valid exercise of the agency's legal authority.

Issued at Austin, Texas on November 10, 2014.



Sara Waitt
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Texas Department of Insurance

The commissioner adopts §7.18 and §7.85.



Julia Rathgeber
Commissioner of Insurance