

**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 proposes amendments to 28 TAC §7.18 and §7.85, concerning the National Association of Insurance Commissioners Accounting Practices and Procedures Manual. The proposed amendments to §7.18 establish a priority of sources for the commissioner, 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 proposed amendments to §7.85 make nonsubstantive updates to Insurance Code and Administrative Code citations.

Consistent with prior versions of §7.18, the sources are: (1) Texas statutes; (2) department 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 the department; and (6) Generally Accepted Accounting Practices.

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. This differs from the department's historical process of periodically adopting the current version of the NAIC manual and all subsequent changes to the prior year's manual by reference. That process has

proved cumbersome and untimely because final subsequent changes are often not adopted until late December, making it impossible to adopt the changes in time for reports that insurers must file annually on or before March 1.

The department also considers the adoption by reference process unnecessary because, under existing rules and this proposal, 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 proposal states the priority of the sources the commissioner will use to make the determinations and provides insurers and health maintenance organizations (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 the department. Even without direct amendments in this section, as provided 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), the department 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 department rule or other state law provides otherwise.

The current manual is 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. Interested persons may comment on potential issues with the 2014 manual under this proposal.

The manual is available for purchase from the NAIC. The March 2014 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. Under the proposal, the department will make available for public inspection, a copy of the current manual and any substantive and nonsubstantive amendments that have been adopted since the publication of the last manual.

The following is a summary of the amendments. Section 7.18(a) has been amended to establish the priority of the sources of information. The subsection retains the priority schedule for determining the proper accounting treatment for an insurance or health plan transaction, and this section provides guidance on how to properly record business transactions for accurate statutory reporting and for preparing all financial statements filed with the department. Section 7.18(b) establishes the requirement to use the manual as it may be amended from time to time.

Section 7.18(c) maintains the existing modifications and exceptions to the manual. Section 7.18(d) maintains existing exemptions from the manual for 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. Section 7.18(e) lists the existing series of rules that are known to preempt the manual. Section 7.18(f) incorporates an existing department practice and clarifies that HMOs may request a permitted

practice to deviate from the required accounting practices in the same manner as insurers.

The amendments to §7.85 make nonsubstantive updates to references to §7.18 and statutory citations. The department has also made nonsubstantive changes in the text to reflect department style guidelines in both §7.18 and §7.85.

**2. FISCAL NOTE.** Danny Saenz, deputy commissioner of the Financial Regulation Division, has determined that, for each of the first five years the amended section is in effect, there will be no fiscal implications for state or local government as a result of enforcing or administering the amended sections, and there will be no effect on local employment or the local economy.

**3. PUBLIC BENEFIT/COST NOTE.** Mr. Saenz also has determined that for each of the first five years the amended sections are in effect, the public benefit of the amendments to §7.18 will be greater certainty in the applicable statutory accounting standards when preparing and filing reports, especially for carriers that are required to comply with accounting requirements in multiple states. The continuous nature of the amended section will also enhance the department's ability to continue efficient financial solvency regulation of insurance in general and avoid the use of its resources to engage in unnecessary rulemaking. The amendments to §7.85 will assist the public in being able to more easily relate the rule to the current applicable statutes.

The department anticipates that amending §7.18 to establish a continuous priority of sources for determining the proper accounting treatment for an insurance or health plan transaction will not result in additional costs to those already required of carriers, regardless of size, under the existing statutes and rules. Insurers were required to use the current year's manual and all subsequent changes to the version under the current rule, which is available for purchase from the NAIC. The department also anticipates that amending §7.85 will not result in additional costs to those already required of carriers, regardless of size, under the existing statutes and rules.

#### **4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY**

**ANALYSIS FOR SMALL AND MICRO BUSINESSES.** Under Government Code §2006.002, the department has determined that the proposed amendments will not result in any additional costs to those already required of small and micro business carriers under the existing statutes and rules.

Under Government Code §2006.002(c), before adopting a rule that may have an adverse economic effect on small or micro businesses, an agency is required to prepare, in addition to an economic impact statement, a regulatory flexibility analysis that includes the agency's consideration of alternative methods of achieving the purpose of the proposed rule. The proposal continues the exemption from compliance with the manual in §7.18(d) for a farm mutual insurance company, statewide mutual assessment company, local mutual aid association, or mutual burial association with less than \$6 million in annual direct

written premiums. Because of the kinds of operations of these types of carriers, they are more likely to be small or micro business carriers. The department bases the exemption on its current application and the fact that these carriers as a class have historically posed relatively insubstantial insolvency-related risk to consumers, other carriers, and the state's general economic welfare.

The department has determined that for other carriers, the routine costs to comply with §7.18 will not have an adverse economic effect on small or micro business carriers. The department has also proposed the means for these carriers to seek an exception from the accounting guidance, either through application for a rule or a permitted practice deviation under §7.18(f). The amendments to §7.85 do not create new requirements from existing rules that would adversely affect a small or micro business. Therefore, the department is not required to consider alternative methods of achieving the purpose of these requirements in the proposed rule as required by Government Code §2006.002(c).

**5. TAKINGS IMPACT ASSESSMENT.** The department has determined that no private real property interests are affected by this proposal and that this proposal does not restrict or limit an owner's right to property that would otherwise exist in the absence of government action, and so does not constitute a taking or require a takings impact assessment under Government Code §2007.043.

**6. REQUEST FOR PUBLIC COMMENT.** To be considered, submit written comments on the proposal no later than 5:00 p.m., Central time, on October 20, 2014. All comments should be submitted to the chief clerk by email at [chiefclerk@tdi.texas.gov](mailto:chiefclerk@tdi.texas.gov), or by mail to Chief Clerk, Mail Code 113-2A, Texas Department of Insurance, P.O. Box 149104, Austin, Texas 78714-9104. You must simultaneously submit an additional copy of your comments by email to Danny Saenz at [danny.saenz@tdi.texas.gov](mailto:danny.saenz@tdi.texas.gov), or by mail to Danny Saenz, Deputy Commissioner, Financial Regulation Division, Texas Department of Insurance, Mail Code 305-2A, P.O. Box 149104, Austin, Texas 78714-9104.

If you want to request a public hearing on the proposal, you must submit the request separately to the Office of the Chief Clerk before the close of the public comment period. If a hearing is held, attendees may present written comments and public testimony at the hearing.

**7. STATUTORY AUTHORITY.** The department proposes 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. The department proposes the amendments to §7.85 under Insurance Code §401.009 and §36.001.

Section 32.041 requires the department to furnish to the companies the required financial statement forms. Sections 401.051 and 401.056 mandate that the department examine the financial condition of each carrier organized under the laws of Texas or authorized to transact the business of insurance in Texas, and 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 the department under the Insurance Code and other laws of this state.

**8. CROSS REFERENCE TO STATUTE.** The proposed 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 proposed amendments to §7.85 affect Insurance Code §401.009.

**9. TEXT.**

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

(a) ~~[The purpose of this section is to adopt statutory accounting principles, which will provide insurers and health maintenance organizations, including accountants employed or retained by these entities, guidance as how to properly record business transactions for the purpose of accurate statutory reporting. The March 2012 version of the Accounting Practices and Procedures Manual (Manual) published by the National Association of Insurance Commissioners~~

~~(NAIC), with the exceptions and modifications set forth in subsections (c) and (d) of this section, will be utilized as the guideline for statutory accounting principles in Texas to the extent the Manual does not conflict with provisions of the Insurance Code or rules of the department.]~~ The commissioner reserves all authority and discretion to resolve any ~~[accounting]~~ 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 the department. 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)~~[Manual]~~. ~~[The department rules preempting any contrary provisions in the Manual, include, but are not limited to: §§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 (relating to Annuity Mortality Tables; Actuarial Opinion and Memorandum Regulation; General Calculation Requirements for Basic Reserves and Premium Deficiency Reserves; Policy Reserves; Claims Reserves; Minimum Reserve Standards for Individual and Group Accident and Health Insurance; the 2001 CSO Mortality Table; Preferred Mortality Tables; Subordinated Indebtedness, Surplus~~

~~Debentures, Surplus Notes, Premium Income Notes, Bonds, or Debentures, and Other Contingent Evidences of Indebtedness; Audited Financial Reports; and Investments, Loans, and Other Assets)-.]~~

- (1) Texas statutes;
- (2) department rules;
- (3) directives, instructions, and orders of the commissioner;
- (4) except as provided in with the exceptions, modifications, and

exemptions set forth in subsections (c) and (d) of this section, the manual

~~[Manual];~~

(5) other NAIC handbooks, manuals, and instructions~~[,]~~ adopted by the department; and

- (6) Generally Accepted Accounting Practices.

(b) The ~~[commissioner adopts by reference the March 2012 version of 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. The department will maintain for public inspection at its offices a copy of the current manual and all substantive and nonsubstantive changes that have been adopted since the last publication. [with the exceptions and modifications set forth in subsections (c) and (d) of this section, as the source of accounting principles for the department when analyzing financial reports and for conducting statutory examinations and rehabilitations of insurers and health maintenance organizations licensed in Texas, except where otherwise provided by law. This

~~Manual that is adopted by reference with the exceptions and modifications specified in subsections (c) and (d) of this section will be applied to examinations conducted as of December 31, 2011, and thereafter, and also must be used to prepare all financial statements filed with the department for reporting periods beginning on or after December 31, 2011.]~~

(c) The commissioner adopts the following ~~[adopted]~~ exceptions and modifications to the manual: ~~[under this subsection must be used to prepare all financial statements required to be filed with the department on or after January 1, 2013, and will be applied to all examinations of those financial statements.]~~

~~[(1) The commissioner adopts by reference the following modifications to the Manual:]~~

~~[(A) Statement of Statutory Accounting Principles (SSAP) Nos. 92, 102, 103, and 104 adopted by the NAIC in calendar year 2012.]~~

~~[(B) Placements revisions to nullify SSAP No. 77 and include real estate sales guidance, related effective dates, and adopted Generally Accepted Accounting Principles references in SSAP No. 40.]~~

~~[(C) The following modifications made by the NAIC in calendar year 2012 to SSAP Nos. 1, 11, 26, 27, 36, 35R, 48, 57, 68, 90, 95, 97, and 101 QA—Clean and 101 QA—Tracked, that do not modify the intent of those or any other SSAP Numbers.]~~

~~[(i) Ref. No. 2004-27: Fund Demand Disclosures for Institutional Business;]~~

~~[(ii) Ref. No. 2011-19: ASU 2010-11: Derivatives and  
Hedging (Topic 815) — Scope Exception Related to Embedded Credit~~

~~Derivatives;~~

~~[(iii) Ref. No. 2011-25: ASU 2011-02, Receivables —  
A Creditors' Determination of Whether a Restructuring is a Troubled Debt~~

~~Restructuring;]~~

~~[(iv) Ref. No. 2011-38: ASU 2011-06, Fees Paid to  
the Federal Government by Health Insurers;]~~

~~[(v) Ref. No. 2011-42: SSAP No. 1 Implementation  
Guide;]~~

~~[ (vi) Ref. No. 2012-01: EITF 06-2: Accounting for  
Sabbatical Leave and Other Similar Benefits Pursuant to FAS No. 43;]~~

~~[ (vii) Ref. No. 2012-02: EITF 07-1, Accounting for  
Collaborative Arrangements;]~~

~~[ (viii) Ref. No. 2012-03: Clarifications to SSAP No.  
57 — Title Insurance;]~~

~~[(ix) Ref. No. 2012-05: Clarification on the  
Amortization of the Basis Difference;]~~

~~[(x) Ref. No. 2012-07: Adopt EAIW Proposed  
Revisions to SSAPs — 2000 INTs;]~~

~~[ (xi) Ref. No. 2012-08: Paragraph Placement in  
SSAP No. 86;~~

~~[(xii) Ref. No. 2012-09: Move Guidance from SSAP No. 95 and Incorporate into SSAP No. 90;]~~

~~[(xiii) Ref. No. 2012-12: Credit for Reinsurance;]~~

~~[(xiv) Ref. No. 2012-13: Reference to Credit Tenant Loans within SSAP No. 26;]~~

~~[(xv) Ref. No. 2012-21: Adopt EAIWG Proposed Revisions to SSAPs – 2001 INTs;]~~

~~[(D) Actuarial Guideline 38 adopted by the NAIC in calendar year 2012.]~~

~~[(2) In addition, the following exceptions and additions are adopted:]~~

(1) ~~[(A)]~~ 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 ~~[(relating to Commissioner's Approval Required)]~~. Intercompany balances must be settled within 90 days of the period for which the amounts are being billed or ~~or~~ ~~otherwise~~ the balances will be nonadmitted.

(2) ~~[(B)]~~ 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 ~~an~~ admitted assets ~~asset~~ 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 [~~Manual~~].

(3) [~~(C)~~] Furniture, labor-saving devices, machines, and all other office equipment may be admitted as assets [~~an asset~~] as permitted by [~~the~~] 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 [~~need~~] not required to comply with the manual [~~Manual~~].

(e) Preemptions.

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

(2) Department 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) [~~(e)~~] 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, [~~made with the deputy commissioner of the~~] 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 [~~is proposed to~~] be affected by the deviated accounting practice. A domestic insurer or health maintenance organization [~~Insurers~~] must not use a deviated accounting practice without the department's prior approval.

(g) [(f)] This section must [~~shall~~] not be construed to either broaden or restrict the authority provided under the Insurance Code to insurers or [~~;~~ ~~including~~] health maintenance organizations.

#### **§7.85. Audited Financial Reports**

(a) Definitions. The following words and terms, when used in this section, will [~~shall~~] 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 [~~;~~ ~~Article 1.15A, §12~~].

(2) Audited Financial Report--The annual audit report required by Insurance Code Chapter 401, Subchapter A [~~;~~ ~~Article 1.15A~~].

(3) Commissioner--The commissioner of insurance. [~~Commissioner of Insurance.~~]

(4) Department--The Texas Department [~~department~~] of Insurance.

(5) Examiner--Staff appointed by the commissioner under  
[~~Commissioner pursuant to~~] Insurance Code Chapter 401, Subchapter C [~~;~~  
Articles 1.17 and 1.18].

~~[(6) Generally Accepted Accounting Principles (GAAP)--The  
conventions, rules, and procedures that define accepted accounting practice,  
including broad guidelines and detailed procedures, set forth by the Accounting  
Principles Board of the American Institute of Certified Public Accountants, which  
was superseded by the Financial Accounting Standards Board, and which  
principles are specifically defined by SAS Number 69 (AU §411.05)]~~

(6) [~~(7)~~] Generally Accepted Auditing Standards (GAAS)--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 the  
department's examiners or other persons or firms retained by the department  
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 [~~defined by~~  
~~Insurance Code, Article 1.15A, §17(a);~~] the accountant's audit planning records;

and any record of communications related to the audit between the accountant and the insurer under [~~pursuant to the~~] Insurance Code §401.020 [~~, Article 1.15A, §17(b)~~].

~~[(11) Material—As defined in the NAIC Accounting Practices and Procedures Manual adopted in §7.18 of this title (relating to NAIC Accounting Practices and Procedures Manual).]~~

(b) Priority of Accounting Guidance. The priority for determining [~~determination of~~] 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 [~~Commissioner pursuant to the~~] Insurance Code §401.007 [~~, Article 1.15A, §6(a)~~], to be substantially similar to the requirements in Insurance Code Chapter 401 [~~, Article 1.15A~~]. 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 [~~Commissioner [pursuant to the]~~] Insurance Code §401.007 [~~, Article 1.15A, §6(a)~~], to be substantially similar to the requirements in Insurance Code Chapter 401 [~~, Article 1.15A~~].

(d) Purpose. [~~The Department recognizes that the~~] Insurance Code Chapter 401 [~~, Article 1.15A,~~] requires audited financial reports to be prepared,

and that statutory examinations are periodically conducted under [~~pursuant to~~] 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 [~~the~~] Insurance Code Chapter 401 must [~~, Article 1.15A, shall~~] be conducted in accord [~~accordance~~] with GAAS. It is not the department's intent to expand audit testing beyond the requirements of GAAS. The accountant conducting the audit must [~~shall~~] 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 [~~Commissioner~~] under §7.68 of this title;

(3) valuation procedures contained in the NAIC Investment Analysis Office's Purposes and Procedures Manual [~~Purposes and Procedures of the Securities Valuation Office manual~~] and §7.18 of this title; and

(4) any order(s) of the commissioner [~~Commissioner~~] issued to a particular company.

(f) Contents of audited financial reports. In addition to the contents specified in ~~the~~ Insurance Code §401.009 [~~Article 1.15A, §10(a) -- (c)~~], audited financial reports must ~~shall~~ 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 the statement of cash flow prepared in accord [~~accordance~~] with the Texas Administrative Code including [~~and~~] the NAIC Annual Statement Instructions adopted by the commissioner [~~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 [~~as required by the~~] Insurance Code §401.009(b) [~~Article 1.15A, §10(c)~~], 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; [~~and~~]

(B) a schedule and explanation of material nonadmitted [~~non-admitted~~] assets;

(C) any and all [~~shall also be recorded in notes. The notes shall also include those~~] items required by the [~~appropriate~~] NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures

Manual [~~Accounting Practices and Procedures Manual.~~] under §7.68 and §7.18  
of this title; and

(D) [~~Furthermore, the notes shall include~~] a reconciliation of any differences, if any, between the audited statutory financial statements and the Annual Statement filed with the department, with a written description of the nature of these 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 [~~shall~~] 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 [~~accordance~~] with the instructions of the NAIC Investment Analysis Office's Purposes and Procedures Manual [~~Purposes and Procedures of the Securities Valuation Office manual~~] and §7.18 of this title.

(B) For assets other than invested assets:

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

(ii) the [~~such~~] assets are valued in accord [~~accordance~~] 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 [~~shall~~] 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 [~~shall~~] 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 [~~accordance~~] with policy and statutory provisions, and that required payments were made under [~~pursuant to~~] 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 [~~shall~~] contain a notation that the accountant has determined that the [~~such~~] entity has: [~~met the requirements of subparagraphs (A) and (B) of this paragraph.~~]

(A) met the filing [~~Filing~~] requirements in [~~have been met of the~~] Insurance Code[;] Chapter 823 and the Texas Administrative Code, including [~~but not limited to~~] the requirements that all shareholder dividends have been reported to the department within two business days after declaration and at least 10 [~~ten~~] days prior to payment as required under Insurance Code §823.053; [;] and that all other dividends have been declared and [~~to have been~~] paid in accord [~~accordance~~] with the applicable provisions of the Insurance Code and the Texas Administrative Code, including Chapter 403, Chapter 1112, §841.253, and [~~Articles 3.11, 21.31, 21.32, 21.32A, or~~] §884.253; and [~~-, whichever statute is applicable.~~]



(B) maintained unencumbered [~~Unencumbered~~] assets [~~have been maintained~~] in an amount at least equal to reserve liabilities as required under [~~by~~] Insurance Code Chapter 422 [~~, Article 21.39-A~~].

(h) Accessibility of work papers. The accountant must [~~shall~~] 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 [~~the~~] Insurance Code §401.020(c) [~~, Article 1.15A, §17(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, [~~Articles 1.15, §8(b); 1.15A, §17(c); 4.48;~~] and [~~§~~]823.011.

(i) Sanction. Failure to comply [~~Noncompliance~~] with this section may result in the commissioner [~~Commissioner~~] initiating action under [~~pursuant to~~] Insurance Code §401.012 [~~Article 1.15A, §12(d)~~] and Chapter 82.

**10. CERTIFICATION.** This agency certifies that legal counsel has reviewed the proposal and found it to be within the agency's authority to adopt.

Issued at Austin, Texas, on September 3, 2014.



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Sara Waitt  
General Counsel  
Texas Department of Insurance