

Title 210 - NEBRASKA DEPARTMENT OF INSURANCE

Chapter 56 - ANNUAL AUDITED FINANCIAL REPORTS

001. Authority. This Rule is promulgated by the Director of Insurance pursuant to Neb. Rev. Stat. §§ 44-101.01, 44-322, 44-1097, 44-1207, and 44-32,162.

002. Purpose.

002.01 The purpose of this Rule is to improve the Nebraska Insurance Department's surveillance of the financial condition of Insurers by requiring (1) an annual audit of financial statements reporting the financial position and the results of operations of Insurers by independent certified public accountants, (2) Communication of Internal Control Related Matters Noted in an Audit, (3) Management's Report of Internal Control over Financial Reporting.

002.02 This Rule shall apply to all Insurers as defined in Section 003.09. Insurers 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 direct written policies nationwide at the end of the calendar year shall be exempt from this Rule for the year (unless the Director makes a specific finding that compliance is necessary for the Director to carry out statutory responsibilities) except that the Insurers having assumed premiums pursuant to contracts and/or treaties of reinsurance of \$1,000,000 or more will not be so exempt.

002.02(a) Assessment associations subject to Neb. Rev. Stat. § 44-801 et. seq. shall be exempt from the requirements of this Rule unless the assessment association is operating in or licensed in another state.

002.03 Foreign or alien Insurers filing Audited financial reports in another state, pursuant to such other state's requirement of Audited financial reports, which has been found by the Director to be substantially similar to

the requirements herein, are exempt from Sections 004 through 013 of this Rule if:

002.03(a) A copy of the Audited financial report, Communication of Internal Control Related Matters Noted in An Audit, and the Accountants' Letter of Qualifications which are filed with such other state are filed with the Director in accordance with the filing

003.03 Audit committee means a committee (or equivalent body) established by the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of an Insurer or Group of insurers, the internal audit function of an insurer or group of insurers (if applicable), and external audits of financial statements of the Insurer or Group of insurers. The Audit committee of any entity that controls a Group of insurers may be deemed to be the Audit committee for one or more of these controlled Insurers solely for the purposes of this Rule at the election of the controlling person. Refer to Section 014.05 for exercising this election. If an Audit committee is not designated by the Insurer, the Insurer's entire board of directors shall constitute the Audit committee.

003.04 Audited financial report means and includes those items specified in Section 005 of this Rule.

003.05 Department means the Nebraska Department of Insurance.

003.06 Director means the Director of Insurance for the State of Nebraska.

003.07 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 or other misrepresentations made by the Insurer or its representatives.

003.08 Independent board member has the same meaning as described in Section 014.03.

003.09 Insurer means any stock insurance company, mutual insurance company, assessment company, reciprocal insurance company, fraternal benefit society or health maintenance organization holding a certificate of authority or license issued by the Department.

003.10 Group of insurers means those licensed Insurers included in the reporting requirements of Neb. Rev. Stat. § 44-2120, or a set of Insurers as identified by management, for the purpose of assessing the effectiveness of Internal control over financial reporting.

003.11 Internal audit function means a person or persons that provide independent, objective, and reasonable assurance designed to add value and improve an organization's operations and accomplish its objectives by

bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

003.12 Internal control over financial reporting means a process effected by an entity's board of directors, management and other personnel designed to provide reasonable assurance regarding the reliability of the financial statements, i.e., those items specified in Section 005.02 through

003.17 Section 404 Report means management's report on internal control over financial reporting as defined by the SEC and the related attestation report of the independent certified public accountant as described in Section 003.01.

003.18 SOX Compliant Entity means an entity that either is required to be compliant with, or voluntarily is compliant with, all of the following provisions of the Sarbanes-Oxley Act of 2002: (i) the preapproval requirements of Section 201 (Section 10A(i) of the Securities Exchange Act of 1934); (ii) the Audit committee independence requirements of Section 301 (Section 10A(m)(3) of the Securities Exchange Act of 1934); and (iii) the Internal control over financial reporting requirements of Section 404 (Item 308 of SEC Regulation S-K).

003.19 Statutory accounting practices has the meaning defined in the current editions of the Annual Statement Instructions and Accounting Practice and Procedures Manuals published by the National Association of Insurance Commissioners, or as otherwise prescribed by the insurance department of the Insurer's state of domicile.

004. General requirements related to filing and extensions for filing of annual Audited financial reports and Audit committee appointment.

004.01 All Insurers shall have an annual audit by an independent certified public accountant and shall file an Audited financial report with the Director on or before June 1 for the year ended December 31 immediately preceding. The Director may require an Insurer to file an Audited financial report earlier than June 1 with ninety (90) days advance notice to the Insurer.

004.02 Extensions of the June 1 filing date may be granted by the Director for thirty-day periods upon a showing by the Insurer and its independent certified public accountant of the reasons for requesting such extension and a determination by the Director of good cause for the 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 Director to make an informed decision with respect to the requested extension.

004.03 If an extension is granted in accordance with the provisions in Section 004.02, a similar extension of thirty (30) days is granted to the filing of Management's Report of Internal Control over Financial Reporting.

004.04 Every Insurer required to file an annual Audited financial report pursuant to this Rule shall designate a group of individuals as constituting its Audit committee, as defined in Section 003. The Audit committee of an entity that controls an Insurer may be deemed to be the Insurer's Audit committee for purposes of this Rule at the election of the controlling person.

006. Designation of independent certified public accountant.

006.01 Each Insurer required by this Rule to file an annual Audited financial report must within sixty (60) days after becoming subject to such requirement, register with the Director in writing the name and address of the independent certified public accountant or accounting firm, generally referred to in this Rule as the accountant, retained to conduct the annual audit set forth in this Rule. Insurers not retaining an independent certified public accountant on the effective date of this Rule shall register the name and address of their retained independent certified public accountant not less than six (6) months before the date when the first Audited financial report is to be filed.

006.02 The Insurer shall obtain a letter from such accountant, and file a copy with the Director stating that the accountant is aware of the provisions of the insurance statutes and the Rules and Regulations of the Insurance Department of the state of domicile that relate to accounting and financial matters and affirming that he or she will express his or her opinion on the financial statements in the 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.

006.03 If an accountant who was the accountant for the immediately preceding filed Audited financial report is dismissed or resigns, the Insurer shall notify the Department of this event within five (5) business days of this event. The Insurer shall also furnish the Director with a separate letter within ten (10) business days of the above notification stating whether in the twenty-four months (24) 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 Insurer responsible for presentation of its financial statements and personnel of the accounting firm responsible for rendering its report. The Insurer shall also in writing request such former accountant to furnish a letter addressed to the Insurer stating whether the accountant agrees with the statements contained in the Insurer's letter and, if not, stating the reasons for which he or she does not

agree; and the Insurer shall furnish such responsive letter from the former accountant to the Director together with its own.

007. Qualifications of independent certified public accountant.

007.01 The Director shall not recognize any person or firm as a qualified independent certified public accountant if the person or firm:

007.04(a)(i) Number of partners, expertise of the partners or the number of insurance clients in the currently registered firm;

007.04(a)(ii) Premium volume of the Insurer; or

007.03(a)(iii) Number of jurisdictions in which the Insurer transacts business.

007.04(b) The Insurer shall file, with its annual statement filing, the approval for relief from Section 007.04(a) with the states that it is licensed in or doing business in and with the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the Insurer shall file the approval in an electronic format acceptable to the NAIC.

007.05 The Director shall neither recognize as a qualified independent certified public accountant, nor accept any annual Audited financial report, prepared in whole or in part by, any natural person who:

007.05(a) Has been convicted of fraud, bribery, a violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Sections 1961-1968, or any dishonest conduct or practices under federal or state law;

007.05(b) Has been found to have violated the insurance laws of this state with respect to any previous reports submitted under this Rule; or

007.05(c) Has demonstrated a pattern or practice of failing to detect or disclose material information in previous reports filed under the provisions of this Rule.

007.06 The Director of Insurance may hold a hearing in accordance with the provisions of the Nebraska Administrative Procedure Act, Neb. Rev. Stat. § 84-901 et. seq., and Title 210, Nebraska Administrative Code, Chapter 26, to determine whether an independent 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 of the financial statements in the annual Audited financial report made pursuant to this Rule and require the Insurer to replace the accountant with another whose relationship with the Insurer is independent within the meaning of this Rule.

007.07

007.07(a) The Director shall not recognize as a qualified independent certified public accountant, nor accept an annual Audited financial report, prepared in whole or in part by an accountant who provides to an Insurer, contemporaneously with

007.07(a)(v) Internal audit outsourcing services;

007.07(a)(vi) Management functions or human resources;

007.07(a)(vii) Broker or dealer, investment adviser, or investment banking services;

007.07(a)(viii) Legal services or expert services unrelated to the audit; or

007.07(a)(ix) Any other services that the Director determines, by regulation, are impermissible.

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

007.08 Insurers having direct written and assumed premiums of less than \$100,000,000 in any calendar year may request an exemption from Section 007.07(a). The Insurer shall file with the Director a written statement discussing the reasons why the Insurer should be exempt from these provisions. If the Director finds, upon review of this statement, that compliance with this Rule would constitute a financial or organizational hardship upon the Insurer, an exemption may be granted.

007.09 A qualified independent certified public accountant who performs the audit may engage in other non-audit services, including tax services, that are not described in Section 007.07(a) or that do not conflict with Section 007.07(b), only if the activity is approved in advance by the Audit committee, in accordance with Section 007.10.

007.10 All auditing services and non-audit services provided to an Insurer by the qualified independent certified public accountant of the Insurer shall be preapproved by the Audit committee. The preapproval requirement is waived with respect to non-audit services if the Insurer is a SOX Compliant Entity or a direct or indirect wholly-owned subsidiary of a SOX Compliant Entity or:

007.10(a) The aggregate amount of all such non-audit services provided to the Insurer constitutes not more than five percent (5%) of the total amount of fees paid by the Insurer to its qualified independent certified public accountant during the fiscal year in which the non-audit services are provided;

007.10(b) The services were not recognized by the Insurer at the

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

008.01 Amounts shown on the consolidated or combined Audited financial report shall be shown on the worksheet;

008.02 Amounts for each Insurer subject to this section shall be stated separately;

008.03 Noninsurance operations may be shown on the worksheet on a combined or individual basis;

008.04 Explanations of consolidating and eliminating entries shall be included; and

008.05 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.

009. Scope of audit and report of independent certified public accountant. Financial statements furnished pursuant to Section 005 hereof shall be examined by an independent certified public accountant. The examination of the Insurer's financial statements shall be conducted in accordance with generally accepted auditing standards. In accordance with AU Section 319 of the Professional Standards of the AICPA, Consideration of Internal Control in a Financial Statement Audit, the independent certified public accountant should obtain an understanding of internal control sufficient to plan the audit. To the extent required by AU 319, for those Insurers required to file a Management's Report of Internal Control over Financial Reporting pursuant to Section 017, the independent certified public accountant should consider (as that term is defined in Statement on Auditing Standards (SAS) No. 102, Defining Professional Requirements in Statements on Auditing Standards or its replacement) the most recently available report in planning and performing the audit of the statutory financial statements. Consideration shall be given to the procedures illustrated in the Financial Condition Examiner's Handbook promulgated by the NAIC as the independent certified public accountant deems necessary.

010. Notification of adverse financial condition.

010.01 The Insurer 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 Insurer has materially misstated its financial condition as reported to the Director as of the balance sheet date currently under audit or that the Insurer does not meet the minimum capital and surplus requirement of the Nebraska insurance statutes as of that date. An Insurer who has received a report pursuant to this paragraph shall forward a copy

011.02 The Insurer is required to provide a description of remedial actions taken or proposed to correct unremediated material weakness, if such actions are not described in the accountant's communication.

012. Accountant's letter of qualifications. The accountant shall furnish the Insurer in connection with, and for inclusion in, the filing of the annual Audited financial report, a letter stating:

012.01 That the accountant is independent with respect to the Insurer and conforms to the standards of his or her profession as contained in the Code of Professional Ethics and pronouncements of the AICPA and the Rules of Professional Conduct of the Nebraska Board of Public Accountancy, or similar code;

012.02 The background and experience in general, and the experience in audits of Insurers of the staff assigned to the engagement and whether each is an independent certified public accountant. Nothing within this Rule 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;

012.03 That the accountant understands the Annual financial report and his opinion thereon will be filed in compliance with this Rule and that the Director will be relying on this information in the monitoring and regulation of the financial position of Insurers;

012.04 That the accountant consents to the requirements of Section 013 of this Rule and that the accountant consents and agrees to make available for review by the Director, or the Director's designee or appointed agent, the workpapers, as defined in Section 013;

012.05 A representation that the accountant is properly licensed by an appropriate state licensing authority and is a member in good standing in the AICPA; and

012.06 A representation that the accountant is in compliance with the requirements of Section 007 of this Rule.

013. Definition, availability and maintenance of independent certified public accountant work papers.

013.01 Work papers 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 an Insurer. Work papers, 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 accountant in the course of his or her audit of the financial statements of an Insurer and which support the accountant's opinion.

014.03 Each member of the Audit committee shall be a member of the board of directors of the Insurer or a member of the board of directors of an entity elected pursuant to Section 014.05 and Section 003.03.

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

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

014.06 To exercise the election of the controlling person to designate the Audit committee for purposes of this Rule, the ultimate controlling person shall provide written notice to the Directors of the affected Insurers. Notification shall be made timely prior to the issuance of the statutory audit report and include a description of the basis for the election. The election can be changed through notice to the Director by the Insurer, which shall include a description of the basis for the change. The election shall remain in effect for perpetuity, until rescinded.

014.07

014.07(a) The Audit committee shall require the accountant that performs for an Insurer any audit required by this Rule to timely report to the Audit committee in accordance with the requirements of SAS 61, Communication with Audit Committees, or its replacement, including:

014.07(a)(i) All significant accounting policies and material permitted practices;

014.07(a)(ii) All material alternative treatments of financial information within statutory accounting principles that have

been discussed with management officials of the Insurer, ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the accountant; and

014.07(a)(iii) Other material written communications between the accountant and the management of the Insurer,

Federal Flood Program, less than \$500,000,000 may make application to the Director for a waiver from the Section 014 requirements based upon hardship. The Insurer shall file, with its annual statement filing, the approval for relief from Section 014 with the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the Insurer shall file the approval in an electronic format acceptable to the NAIC.

015. Internal Audit Function Requirements

015.01 Exemption. An insurer is exempt from the requirements of this section if:

015.01(a) The insurer has annual direct written and unaffiliated assumed premium, including international direct and assumed premium but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, less than \$500,000,000; and,

015.01(b) If the insurer is a member of a group of insurers, the group has annual direct written and unaffiliated assumed premium including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, less than \$1,000,000,000.

015.02 Function. The insurer or group of insurers shall establish an internal audit function providing independent, objective and reasonable assurance to the Audit committee and insurer management regarding the insurer's governance, risk management and internal controls. This assurance shall be provided by performing general and specific audits, reviews and tests and by employing other techniques deemed necessary to protect assets, evaluate control effectiveness and efficiency, and evaluate compliance with policies and regulations.

015.03 Independence. In order to ensure that internal auditors remain objective, the Internal audit function must be organizationally independent. Specifically, the Internal audit function will not defer ultimate judgment on audit matters to others, and shall appoint an individual to head the Internal audit function who will have direct and unrestricted access to the board of directors. Organizational independence does not preclude dual-reporting relationships.

015.04 Reporting. The head of the internal audit function shall report to the audit committee regularly, but no less than annually, on the periodic

audit plan, factors that may adversely impact the Internal audit function's independence or effectiveness, material findings from completed audits and the appropriateness of corrective actions implemented by management as a result of audit findings.

015.05 Additional Requirements. If an insurer is a member of an insurance holding company system or included in a group of insurers, the

the commissioner, generally accepted auditing standards, or other professional or regulatory standards);

016.03(b) Not to perform audit, review or other procedures required by generally accepted auditing standards or other professional standards;

016.03(c) Not to withdraw an issued report; or

016.03(d) Not to communicate matters to an Insurer's Audit committee.

017. Management's report of internal control over financial reporting.

017.01 Every Insurer required to file an Audited financial report pursuant to this Rule that has annual direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of \$500,000,000 or more shall prepare a report of the Insurer's or Group of insurers' Internal control over financial reporting, as these terms are defined in Section 003. The report shall be filed with the Director along with the Communication of Internal Control Related Matters Noted in an Audit described under Section 011. Management's Report of Internal Control over Financial Reporting shall be as of December 31 immediately preceding.

017.02 Notwithstanding the premium threshold in Section 017.01, the Director may require an Insurer to file Management's Report of Internal Control over Financial Reporting if the Insurer is in any RBC level event, or meets any one or more of the standards of an Insurer deemed to be in hazardous financial condition as defined in (include reference to Corrective Action statute).

017.03 An Insurer or a Group of insurers that is

017.03(a) directly subject to Section 404;

017.03(b) part of a holding company system whose parent is directly subject to Section 404;

017.03(c) not directly subject to Section 404 but is a SOX Compliant Entity; or

017.03(d) a member of a holding company system whose parent is not directly subject to Section 404 but is a SOX Compliant Entity;

may file its or its parent's Section 404 Report and an addendum in satisfaction of this Section 017 requirement provided that those internal controls of the Insurer or Group of insurers having a material impact on the preparation of the Insurer's or Group of insurers' audited statutory financial statements (those items included in Section 005.02 through 005.07 of this Rule) were included in the scope of the Section 404 Report.

management as of December 31 immediately preceding. Management is not permitted to conclude that the Internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles if there is one or more unremediated material weaknesses in its Internal control over financial reporting;

017.04(f) A statement regarding the inherent limitations of Internal control systems; and

017.04(g) Signatures of the chief executive officer and the chief financial officer (or equivalent position/title).

017.05 Management shall document and make available upon financial condition examination the basis upon which its assertions, required in Section 017.04 above, are made. Management may base its assertions, in part, upon its review, monitoring and testing of internal controls undertaken in the normal course of its activities.

017.05(a) Management shall have discretion as to the nature of the Internal control framework used, and the nature and extent of documentation, in order to make its assertion in a cost effective manner and, as such, may include assembly of or reference to existing documentation.

017.05(b) Management's Report on Internal Control over Financial Reporting, required by Section 017.01 above, and any documentation provided in support thereof during the course of a financial condition examination, shall be kept confidential by the Department.

018. Exemptions and effective dates.

018.01 Upon written application of any Insurer, the Director may grant an exemption from compliance with any and all provisions of this Rule if the Director finds, upon review of the application, that compliance with this Rule would constitute a financial or organizational hardship upon the Insurer. An exemption may be granted at any time and from time to time for a specified period or periods. Within ten (10) days from a denial of an Insurer's written request for an exemption from this Rule, such Insurer may request in writing a hearing on its application for an exemption. Such hearing shall be held in accordance with the Nebraska Administrative

subject to the reporting requirements shall have two (2) years following the year the threshold is exceeded (but not earlier than December 31, 2010) to file a report. Likewise, an Insurer acquired in a business combination shall have two (2) calendar years following the date of acquisition or combination to comply with the reporting requirements.

018.08 The requirements of Section 015 are to be in effect January 1, 2018. If an insurer or Group of insurers that is exempt from Section 015 requirements no longer qualifies for that exemption, it shall have one year after the year the threshold is exceeded to comply with the requirements of this article.

019. Canadian and British companies.

019.01 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 supervision authority duly audited by an independent chartered accountant.

019.02 For such Insurers, the letter required in Section 006.02 shall state that the accountant is aware of the requirements relating to the annual Audited financial report filed with the Director pursuant to Section 004 and shall affirm that the opinion expressed is in conformity with such requirements.

020. Severability provision. If any Section or portion of a Section of this Rule or its applicability to any person or circumstance is held invalid by a court, the remainder of the rule or the applicability of such provision to other persons or circumstances shall not be affected.