

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Amendment and Compilation of Chapter 16-185
Hawaii Administrative Rules

MMM DD, YYYY

1. Chapter 16-185, Hawaii Administrative Rules, entitled "Annual Audited Financial Reporting", is amended and compiled to read as follows:

"HAWAII ADMINISTRATIVE RULES

TITLE 16

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

CHAPTER 185

ANNUAL AUDITED FINANCIAL REPORTING

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§16-185-101 Purpose and scope. (a) The purpose of this chapter is to improve the surveillance of the financial condition of insurers by requiring the following:

- (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, and
 - (3) Management's report of internal control over financial reporting.
- (b) Every insurer shall be subject to this chapter.
- (c) A foreign or alien insurer filing the following documents in another state, pursuant to that

state's requirement for filing of audited financial reports, is exempt from filing those reports in this State provided that the other state has substantially similar requirements to sections 16-185-103 through 16-185-112, Hawaii Administrative Rules, and those reports are filed with the commissioner of the other state within the time specified:

- (1) An audited financial report;
- (2) A communication of internal control related matters noted in an audit; and
- (3) An accountant's letter of qualifications.
- (d) Foreign or alien insurers required to file

management's report of internal control over financial reporting in another state are exempt from filing the report in this State provided the other state has substantially similar reporting requirements in section 16-185-115, Hawaii Administrative Rules, and the report is filed with the commissioner of the other state within the time specified.

(e) This chapter shall not prohibit, preclude, or in any way limit the commissioner from ordering, conducting, or performing examinations of insurers under the rules of the insurance division.

[Eff 2/04/10; am and

comp

] (Auth: HRS

§431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5)

§16-185-102 Definitions. As used in this chapter:

"Accountant" or "independent certified public accountant" means a person or accounting firm licensed in good standing with the American Institute of Certified Public Accountants [~~("AICPA")~~] and in all states in which the accountant or independent certified public accountant is licensed to practice. For Canadian and British companies, these terms mean a Canadian-chartered or British-chartered accountant.

An "affiliate" of, or person "affiliated" with a specific person, is one who directly or indirectly, through one or more intermediaries, controls or is

controlled by, or is under common control with the person specified.

~~["AICPA" means the American Institute of Certified Public Accountants.]~~

"Audit committee" means a 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 an insurer or 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 chapter at the election of the controlling person as discussed in sections 16-185-103(d) and ~~[16-185-113(f),]~~ 16-185-113(g), Hawaii Administrative Rules. If an audit committee is not designated by the insurer, the insurer's entire board of directors shall constitute the audit committee.

"Audited financial report" means and includes those items specified in section 16-185-104~~[.]~~ , Hawaii Administrative Rules.

"Commissioner" or "insurance commissioner" means the Hawai`i insurance commissioner, unless otherwise specified.

"Division" or "insurance division" means the Hawai`i insurance division.

"Group of insurers" means those licensed insurers included in the reporting requirements of Hawai`i Revised Statutes ("HRS"), chapter 431, article 11, or a set of insurers as identified by management, for the purpose of assessing the effectiveness of internal control over financial reporting.

"Indemnification" means an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the person or firm for failure to adhere to applicable auditing or professional standards, whether or not resulting in part from knowing of other

misrepresentations made by the insurer or its representatives.

"Insurer" means a licensed entity as defined in ~~[sections]~~ section 431:1-202, HRS, and a risk retention captive insurance company as defined in section 431:19-101, HRS.

"Internal audit function" means a person or persons that provide independent, objective, and reasonable assurance designed to add value and improvement to an organization's operations and accomplish its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

"Internal control over financial reporting" means a process effected by an entity's board of directors, management, or other personnel designed to provide reasonable assurance regarding the reliability of the financial statements, i.e., those items specified in section 16-185-104(2) through (7), Hawaii Administrative Rules, and includes those policies and procedures that:

- (1) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets;
- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements, i.e., those items specified in section 16-185-104(2) through (7), Hawaii Administrative Rules, and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and
- (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of assets that could have a material effect on the financial statements, i.e., those items specified in section 16-

185-104(2) through (7), Hawaii
Administrative Rules.

"Material weakness" has the same meaning as defined by the Statement on Auditing Standard 115, Communication of Internal Control Related Matters Identified in an Audit, as amended or replaced.

~~["NAIC" means the National Association of Insurance Commissioners.~~

~~"RBC" means risk-based capital.~~

~~"SEC" means the United States Securities and Exchange Commission.]~~

"Section 404" means section 404 of the Sarbanes-Oxley Act of 2002 and the SEC's rules and regulations promulgated thereunder.

"Section 404 report" means management's report on "internal control over financial reporting" as defined by the United States Securities and Exchange Commission and the related attestation report of the independent certified public accountant.

"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:

- (1) The preapproval requirements of section 201 (section 10A(i) of the Securities Exchange Act of 1934);
- (2) The audit committee independence requirements of section 301 (section 10A(m)(3) of the Securities Exchange Act of 1934); and
- (3) The internal control over financial reporting requirements of section 404 (item 308 of United States Securities and Exchange Commission Regulation S-K). [Eff 2/04/10; am and comp]
(Auth: HRS §431:2-201) (Imp: HRS
§§431:2-201, 431:3-302.5)

§16-185-103 General requirements related to filing and extensions for filing of annual audited financial report and audit committee appointment. (a)

All insurers required by this chapter to file an annual audit by an independent certified public accountant shall file an audited financial report with the commissioner on or before June 1 for the year ended December 31 immediately preceding. The commissioner may require an insurer to file an audited financial report earlier than June 1, with ninety days advance notice to the insurer.

(b) Extensions of the June 1 filing date may be granted by the commissioner for thirty day periods upon a showing by the insurer and its independent certified public accountant of the reasons for requesting an extension and determination by the commissioner of good cause for an extension. The request for extension shall be submitted in writing not less than ten days prior to the due date and in sufficient detail to permit the commissioner to make an informed decision with respect to the requested extension.

(c) If an extension is granted in accordance with the provisions in subsection (b), a similar extension of thirty days is granted to the filing of management's report of internal control over financial reporting.

(d) Every insurer required to file an annual audited financial report shall designate a group of individuals as constituting its audit committee, as defined in section 16-185-102[-] , Hawaii Administrative Rules. [Eff 2/04/10; am and comp] (Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5)

§16-185-104 Contents of annual audited financial report. The annual audited financial report shall report the financial position of the insurer as of the end of the most recent calendar year and the results of its operations, cash flows, and changes in capital

and surplus for the year then ended in conformity with statutory accounting practices prescribed, or otherwise permitted, by the insurance division. The annual audited financial report shall include the following:

- (1) A report by an independent certified public accountant;
- (2) A balance sheet reporting admitted assets, liabilities, capital, and surplus;
- (3) A statement of operations;
- (4) A statement of cash flow;
- (5) A statement of changes in capital and surplus;
- (6) Notes to financial statements. These notes shall be those required by the appropriate [~~NAIC~~] National Association of Insurance Commissioners Annual Statement Instructions and the [~~NAIC~~] National Association of Insurance Commissioners Accounting Practices and Procedures Manual. The notes shall include a reconciliation of differences, if any, between the audited statutory financial statements and the annual statement filed pursuant to section 431:3-302, HRS, and the annual statement filed pursuant to section 431:3-301, HRS, with a written description of the nature of these differences.
- (7) The financial statements included in the audited financial report shall be prepared in a form and using language and groupings substantially the same as the relevant sections of the annual statement of the insurer filed with the commissioner, and the financial statement shall be comparative, presenting the amounts as of December 31 of the current year and the amounts as of the immediately preceding December 31. In the first year in which an insurer is required to file an audited financial report, however, the comparative data may be omitted[+]. [Eff 2/04/10; am and comp]

(Auth: HRS §431:2-201) (Imp: HRS
§§431:2-201, 431:3-301, 431:3-302.5)

§16-185-105 Designation of independent certified public accountant. (a) Each insurer required by this chapter to file an annual audited financial report shall within sixty days after becoming subject to this requirement, register with the commissioner in writing the name and address of the independent certified public accountant or accounting firm retained to conduct the annual audit set forth in this chapter. Insurers not retaining an independent certified public accountant on the effective date of this chapter shall register the name and address of their retained independent certified public accountant not less than six months before the date when the first audited financial report is to be filed.

(b) The insurer shall obtain a letter from the accountant, and file a copy with the commissioner stating that the accountant is aware of the provisions of the statutes and the rules of the Hawai`i insurance division or the insurance department of the state of domicile that relate to accounting and financial matters and affirming that the accountant will express his or her opinion on the financial statements in terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by the Hawai`i insurance division or that insurance department, specifying such exceptions as he or she may believe appropriate.

(c) If an accountant, who was the accountant for the immediately preceding filed audited financial report, is dismissed or resigns, the insurer shall:

- (1) Within five business days notify the commissioner of this event;
- (2) Furnish the commissioner with a separate letter, within ten business days of the notification, stating whether in the twenty-four months preceding such event there were any disagreements with the former accountant

on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of the former accountant, would have caused him or her to make reference to the subject matter of the disagreement in connection with his or her opinion;

- (3) Report disagreements required to be reported in response to this subsection including 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; and
- (4) In writing, request the 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 why that accountant does not agree. The insurer shall furnish to the commissioner copies of its request within five business days of sending the request and the responsive letter from the former accountant within five business days after its receipt.

[Eff 2/04/10;

comp

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Auth: HRS §431:2-201) (Imp: HRS
§§431:2-201, 431:3-302.5)

§16-185-106 Qualifications of independent certified public accountant. (a) The commissioner shall not recognize a person or firm as a qualified

independent certified public accountant if the person or firm:

- (1) Is not in good standing with the [AICPA] American Institute of Certified Public Accountants and in all states in which the accountant is licensed to practice or, for a Canadian or British company, that is not a chartered accountant; or
- (2) Has either directly or indirectly entered into an agreement of indemnity or release from liability (collectively referred to as indemnification) with respect to the audit of the insurer.

(b) Except as otherwise provided in this chapter, the commissioner shall recognize an independent certified public accountant as qualified as long as that person conforms to the standards of the accounting profession, as contained in the code of professional ethics of the [AICPA] American Institute of Certified Public Accountants, [~~HRS~~] chapter 466[~~, Hawaii Administrative Rules~~] , HRS, chapter 16-71, Hawaii Administrative Rules, and the Hawai`i board of public accountancy, or similar statutes, rules, and code of conduct regulating the practice of accountancy in the state in which the accountant is licensed to practice.

(c) A qualified independent certified public accountant may enter into an agreement with an insurer to have disputes relating to an audit resolved by mediation or arbitration. However, in the event of a delinquency proceeding commenced against the insurer under article 15, chapter 431, HRS, the mediation or arbitration provisions shall operate at the option of the insurer's statutory successor.

- (d) (1) The lead or coordinating audit partner having primary responsibility for the audit may not act in that capacity for more than five consecutive years. Thereafter, that partner shall be disqualified from acting in that or a similar capacity for the same company or its insurance subsidiaries or affiliates for a period of five consecutive

years. An insurer may make application to the commissioner for relief from the above rotation requirement on the basis of unusual circumstances. This application should be made at least thirty days before the end of the calendar year. The commissioner may consider the following factors in determining if the relief should be granted:

- (A) Number of partners, expertise of the partners, or the number of insurance clients in the currently registered firm;
 - (B) Premium volume of the insurer; or
 - (C) Number of jurisdictions in which the insurer transacts business; and
- (2) The insurer shall file, with its annual statement filing, the approval for relief from subsection (d)(1) with the states in which it is licensed in or doing business and with the ~~[NAIC.]~~ National Association of Insurance Commissioners. If the nondomestic state accepts electronic filing with the ~~[NAIC,]~~ National Association of Insurance Commissioners, the insurer shall file the approval in an electronic format acceptable to the ~~[NAIC.]~~ National Association of Insurance Commissioners.
- (e) The commissioner shall neither recognize as a qualified independent certified public accountant nor accept an annual audited financial report, prepared in whole or in part, by a natural person who:
- (1) Has been convicted of fraud, bribery, a violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. sections 1961 to 1968, or any dishonest conduct or practices under federal or state law;
 - (2) Has been found to have violated the insurance laws of this state; or
 - (3) Has demonstrated a pattern or practice of failing to detect or disclose material

information in previous reports filed under the provisions of this chapter.

(f) Subject to sections 431:2-308 and 431:3-302.5, HRS, the commissioner may hold a hearing 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 on the financial statements in the annual audited financial report made pursuant to this chapter and require the insurer to replace the accountant with another whose relationship with the insurer is qualified within the meaning of this chapter.

(g) (1) The commissioner shall not recognize as a qualified independent certified public accountant nor accept an annual audited financial report, prepared in whole or in part by an accountant who provides to an insurer, contemporaneously with the audit, the following non-audit services:

- (A) Bookkeeping or other services related to the accounting records or financial statements of the insurer;
- (B) Financial information systems design and implementation;
- (C) Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- (D) Actuarially-oriented advisory services involving the determination of amounts recorded in the financial statements. The accountant may assist an insurer in understanding the methods, assumptions, and inputs used in the determination of amounts recorded in the financial statement, only if it is reasonable to conclude that the services provided will not be subject to audit procedures during an audit of the insurer's financial statements. An accountant's actuary may also issue an actuarial opinion or certification on an

insurer's reserves if the following conditions have been met:

- (i) Neither the accountant nor the accountant's actuary has performed any management functions or made any management decisions;
- (ii) The insurer has competent personnel or engages a third party actuary to estimate the reserves for which management takes responsibility; and
- (iii) The accountant's actuary tests the reasonableness of the reserves after the insurer's management has determined the amount of the reserves;

(E) Internal audit outsourcing services;

(F) Management functions or human resources;

(G) Broker or dealer, investment adviser, or investment banking services;

(H) Legal services or expert services unrelated to the audit; or

(I) Any other services that the commissioner determines, by regulation, are impermissible.

- (2) 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:

(A) Cannot function in the role of management;

(B) Cannot audit his or her own work; and

(C) Cannot serve in an advocacy role for the insurer.

(h) Insurers having direct written and assumed premiums of less than \$100,000,000 in any calendar year may request an exemption from subsection (g). The insurer shall file with the commissioner a written

statement discussing the reasons why the insurer should be exempt from these provisions. If the commissioner finds, upon review of this statement, that compliance with subsection (g) would constitute a financial or organizational hardship upon the insurer, an exemption may be granted.

(i) 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 or that do not conflict with subsection (g), only if the activity is approved in advance by the audit committee, in accordance with subsection (j).

(j) 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:

- (1) The aggregate amount of all such non-audit services provided to the insurer constitutes not more than five per cent 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;
- (2) The services were not recognized by the insurer at the time of the engagement to be non-audit services; and
- (3) The services are promptly brought to the attention of the audit committee and approved prior to the completion of the audit by the audit committee or by one or more members of the audit committee who are the members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

(k) The audit committee may delegate to one or more designated members of the audit committee the authority to grant the preapprovals required by

subsection (j). The decisions of any member to whom this authority is delegated shall be presented to the full audit committee at each of its scheduled meetings.

- (1) (1) The commissioner shall not recognize an independent certified public accountant as qualified for a particular insurer if a member of the board, president, chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for that insurer, was employed by the independent certified public accountant and participated in the audit of that insurer during the one-year period preceding the date that the most current statutory opinion is due. This paragraph shall only apply to partners and senior managers involved in the audit. An insurer may make application to the commissioner for relief from the above requirement on the basis of unusual circumstances.
- (2) The insurer shall file, with its annual statement filing, the approval for relief from subsection (1) (1) with the states that it is licensed in or doing business in and the ~~[NAIC.]~~ National Association of Insurance Commissioners. If the nondomestic state accepts electronic filing with the ~~[NAIC,]~~ National Association of Insurance Commissioners, the insurer shall file the approval in an electronic format acceptable to the ~~[NAIC.]~~ National Association of Insurance Commissioners. [Eff 2/04/10; am and comp]
(Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:2-308, 431:3-302.5)

§16-185-107 Consolidated or combined audits. An insurer may make written application to the

commissioner for approval to file audited consolidated or combined financial statements in lieu of separate annual audited financial statements if the insurer is part of a group of insurance companies that utilizes a pooling or one hundred per cent reinsurance agreement that affects the solvency and integrity of the insurer's reserves and the insurer cedes all of its direct and assumed business to the pool. In such cases, a columnar consolidating or combining worksheet shall be filed with the report, as follows:

- (1) Amounts shown on the consolidated or combined audited financial report shall be shown on the worksheet;
- (2) Amounts for each insurer subject to this section shall be stated separately;
- (3) Noninsurance operations may be shown on the worksheet on a combined or individual basis;
- (4) Explanations of consolidating and eliminating entries shall be included; and
- (5) 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. [Eff 2/04/10; comp]
(Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5)

§16-185-108 Scope of audit and report of independent certified public accountant. (a)

Financial statements furnished pursuant to section 16-185-104 shall be examined by the independent certified public accountant.

(b) The audit of the insurer's financial statements shall be conducted in accordance with generally accepted auditing standards. In accordance with AU section 314 of the Professional Standards of the ~~[AICPA]~~ American Institute of Certified Public Accountants, Understanding the Entity and its Environment and Assessing the Risks of Material

[~~Misstatement,~~] Misstatement, as amended or replaced, the independent certified public accountant shall obtain an understanding of internal control sufficient to plan the audit. To the extent required by AU 314, for those insurers required to file a management's report of internal control over financial reporting pursuant to section 16-185-115, Hawaii Administrative Rules, 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 as amended or replaced, 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 Examiners Handbook promulgated by the [~~NAIC~~] National Association of Insurance Commissioners as the independent certified public accountant deems necessary. [Eff 2/04/10; am and comp] (Auth: HRS §431:2-201) (Imp: HRSS§ 431:2-201, 431:3-302.5)

§16-185-109 Notification of adverse financial condition. (a) The insurer required to furnish the annual audited financial report shall require the independent certified public accountant to report, in writing, within five 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 commissioner as of the balance sheet date currently under audit or that the insurer does not meet the minimum capital and surplus requirement of the Hawai'i insurance code as of that date. An insurer that has received a report pursuant to this paragraph shall forward a copy of the report to the commissioner within five business days of receipt of the report and shall provide the independent certified public accountant making the report with evidence of the report being furnished to

the commissioner. If the independent certified public accountant fails to receive the evidence within the required five business day period, the independent certified public accountant shall furnish to the commissioner a copy of its report within the next five business days.

(b) No independent certified public accountant shall be liable in any manner to any person for any statement made in connection with the above paragraph if the statement is made in good faith in compliance with subsection (a).

(c) If the accountant, subsequent to the date of the audited financial report filed pursuant to this chapter, becomes aware of facts that might have affected the report, the accountant shall take appropriate action as prescribed in volume 1, section AU 561 of the Professional Standards of the ~~[AICPA.]~~ American Institute of Certified Public Accountants.

[Eff 2/04/10; am and

comp

] (Auth: HRS

§431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5)

§16-185-110 Communication of internal control related matters noted in an audit. (a) In addition to the annual audited financial report, each insurer shall furnish the commissioner with a written communication as to any unremediated material weaknesses in its internal control over financial reporting noted during the audit. Such communication shall be prepared by the accountant within sixty days after the filing of the annual audited financial report, and shall contain a description of any unremediated material weakness as of December 31 immediately preceding, so as to coincide with the audited financial report discussed in section 16-185-103, Hawaii Administrative Rules, in the insurer's internal control over financial reporting noted by the accountant during the course of their audit of the financial statements. ~~[If no unremediated material weaknesses were noted, the]~~ The communication should

~~[so state.]~~ state if no unremediated material weaknesses were noted.

(b) The insurer is required to provide a description of remedial actions taken or proposed to correct unremediated material weaknesses, if the actions are not described in the accountant's communication. [Eff 2/04/10; am and comp] (Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5)

§16-185-111 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:

(a) That the accountant is independent with respect to the insurer and conforms to the standards of the accounting profession, as contained in the code of professional ethics of the American Institute of Certified Public Accountants, [~~HRS~~] chapter 466[~~— Hawaii Administrative Rules~~] , HRS, chapter 16-71, Hawaii Administrative Rules, and the Hawaii board of public accountancy, or similar statutes, rules, and code of conduct regulating the practice of accountancy in the state in which the accountant is licensed to practice;

(b) 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 chapter shall be construed as prohibiting the accountant from utilizing such staff as he or she deems appropriate where that use is consistent with the standards prescribed by generally accepted auditing standards;

(c) That the accountant understands the annual audited financial report and his or her opinion thereon will be filed in compliance with this chapter and that the commissioner will be relying on this

information in the monitoring and regulation of the financial position of insurers;

(d) That the accountant consents to the requirements of section 16-185-112 and consents and agrees to make available for review by the commissioner, or the commissioner's designee or appointed agent, the workpapers as defined in section 16-185-112[+] , Hawaii Administrative Rules;

(e) A representation that the accountant is properly licensed by an appropriate state licensing authority and is a member in good standing in the [~~AICPA;~~] American Institute of Certified Public Accountants; and

(f) A representation that the accountant is in compliance with the requirements of section 16-185-106[-] , Hawaii Administrative Rules. [Eff 2/04/10; am and comp] (Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5)

§16-185-112 Definition, availability, and maintenance of independent certified public accountants workpapers. (a) Workpapers are the records kept by the independent certified public accountant of the procedures followed, the tests performed, the information obtained, and the conclusions reached pertinent to the accountant's audit of the financial statements of an insurer. Accordingly, workpapers may include audit planning documentation, work programs, analyses, memoranda, letters of confirmation and representation, abstracts of company documents and schedules, or commentaries prepared or obtained by the independent certified public accountant in the course of his or her audit of the financial statements of an insurer and which support the accountant's opinion.

(b) Every insurer required to file an audited financial report pursuant to this chapter, shall require the accountant to make available for review by insurance division examiners, all workpapers prepared in the conduct of the accountant's audit and any communications related to the audit between the

accountant and the insurer, at the offices of the insurer, at the insurance division or at any other reasonable place designated by the commissioner. The insurer shall require that the accountant retain the audit workpapers and communications until the insurance division has filed a report on examination covering the period of the audit but no longer than seven years from the date of the audit report.

(c) In the conduct of the aforementioned periodic review by the insurance division examiners, it shall be agreed that photocopies of pertinent audit workpapers may be made and retained by the division. Such reviews by the division examiners shall be considered investigations and all working papers and communications obtained during the course of such investigations shall be afforded the same confidentiality as other examination workpapers generated by the division. [Eff 2/04/10; comp] (Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5)

§16-185-113 Requirements for audit committees.

(a) This section shall not apply to foreign or alien insurers licensed in this State or an insurer that is a SOX compliant entity or a direct or indirect wholly-owned subsidiary of a SOX compliant entity.

(b) The audit committee shall be directly responsible for the appointment, compensation, and oversight of the work of any accountant, including resolution of disagreements between management and the accountant regarding financial reporting, for the purpose of preparing or issuing the audited financial report or related work pursuant to this chapter. Each accountant shall report directly to the audit committee.

(c) Beginning January 1, 2020, the audit committee of an insurer or group of insurers shall be responsible for overseeing the insurer's internal audit function and granting the person or persons performing the function suitable authority and

resources to fulfill their responsibilities if required by section 16-185-113.1, Hawaii Administrative Rules.

~~[(e)]~~ (d) 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 subsection ~~[(f)].~~ (g).

~~[(d)]~~ (e) 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.

~~[(e)]~~ (f) 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 commissioner, 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. In determining independence, the commissioner shall consider utilizing guidance provided in the [SEC's] Securities and Exchange Commission's Final Rule No. 33-8220, Standards Relating to Listed Company Audit Committees adopted April 9, 2003, as amended or replaced.

~~[(f)]~~ (g) To exercise the election of the controlling person to designate the audit committee for purposes of this chapter, the ultimate controlling person shall provide written notice to the commissioners 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 commissioner by the insurer, which shall include a description of the basis for the change. The election shall remain in effect for perpetuity, until rescinded. ~~[(g)(1)]~~ (h)(1) The audit committee shall require the accountant, who performs for an insurer any audit required by this chapter, to timely report to the audit committee in accordance with the requirements of ~~[SAS]~~ Statement on Auditing Standards 114, The Auditor's Communication with those charged with Governance, as amended or replaced, including:

- (A) All significant accounting policies and material permitted practices;
 - (B) 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
 - (C) Other material written communications between the accountant and the management of the insurer, such as any management letter or schedule of unadjusted differences.
- (2) If an insurer is a member of an insurance holding company system, the reports required by subsection ~~[(g)(1)]~~ (h)(1) may be provided to the audit committee on an aggregate basis for insurers in the holding company system, provided that any substantial differences among insurers in the system are identified to the audit committee.

~~[(h)(1)]~~ (i)(1) The proportion of independent audit committee members shall meet or exceed the following criteria:

Prior Calendar Year Direct Written and Assumed Premiums		
\$0 - \$300,000,000	Over \$300,000,000 - \$500,000,000	Over \$500,000,000
No minimum requirements. See also paragraphs [(h)(2)] <u>(i)(2)</u> and [(h)(3)] . <u>(i)(3)</u> .	Majority (50% or more) of members shall be independent. See also paragraphs [(h)(2)] <u>(i)(2)</u> and [(h)(3)] . <u>(i)(3)</u> .	Supermajority of members (75% or more) shall be independent. See also paragraph [(h)(2)] . <u>(i)(2)</u> .

- (2) The commissioner has authority afforded by state law to require the entity's board to enact improvements to the independence of the audit committee membership if the insurer is in a ~~[RBC]~~ risk-based capital action level event, meets one or more of the standards of an insurer deemed to be in hazardous financial condition, or otherwise exhibits qualities of a troubled insurer.
- (3) All insurers with less than \$500,000,000 in prior year direct written and assumed premiums are encouraged to structure their audit committees with at least a supermajority of independent audit committee members.
- (4) Prior calendar year direct written and assumed premiums shall be the combined total of direct premiums and assumed premiums from non-affiliates for the reporting entities.

~~[(i)]~~ (j) An insurer with direct written and assumed premium, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, less than \$500,000,000 may make application to the commissioner for a waiver from the section 16-185-113, Hawaii Administrative Rules, requirements

based upon hardship. The insurer shall file, with its annual statement filing, the approval for relief from section 16-185-113, Hawaii Administrative Rules, with the states that it is licensed in or doing business in and the ~~[NAIC.]~~ National Association of Insurance Commissioners. If the nondomestic state accepts electronic filing with the ~~[NAIC,]~~ National Association of Insurance Commissioners, the insurer shall file the approval in an electronic format acceptable to the ~~[NAIC.]~~ National Association of Insurance Commissioners. [Eff 2/04/10; am and comp] (Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5)

§16-185-113.1 Internal audit function

requirements. (a) 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.

(b) 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 judgement 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.

(c) 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.

(d) If an insurer is a member of an insurance holding company system or included in a group of insurers, the insurer may satisfy the internal audit function requirements set forth in this section at the ultimate controlling parent level, an intermediate holding company level, or the individual legal entity level.

(e) An insurer is exempt from the requirements of this section if:

(1) 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

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

[Eff _____] (Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5)

§16-185-114 Conduct of insurer in connection with the preparation of required reports and documents. (a)

No director or officer of an insurer shall, directly or indirectly:

(1) Make or cause to be made a materially false or misleading statement to an accountant in connection with any audit, review, or

communication required under this chapter;
or

- (2) Omit to state, or cause another person to omit to state, any material fact necessary, in light of the circumstances under which the statements were made, so as to mislead an accountant in connection with any audit, review, or communication required under this chapter.

(b) No officer or director of an insurer, or any other person acting under the direction thereof, shall directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence any accountant engaged in the performance of an audit pursuant to this chapter if that person knew or should have known that the action, if successful, could result in rendering the insurer's financial statements materially misleading.

(c) For purposes of subsection (b), actions that, "if successful, could result in rendering the insurer's financial statements materially misleading" include, but are not limited to, actions taken at any time with respect to the professional engagement period to coerce, manipulate, mislead, or fraudulently influence an accountant:

- (1) To issue or reissue a report on an insurer's financial statements that is not warranted in the circumstances due to material violations of statutory accounting principles prescribed by the commissioner, generally accepted auditing standards, or other professional or regulatory standards;
- (2) Not to perform audit, review, or other procedures required by generally accepted auditing standards or other professional standards;
- (3) Not to withdraw an issued report; or
- (4) Not to communicate matters to an insurer's audit committee. [Eff 2/04/10;

comp]
(Auth: HRS §431:2-201) (Imp: HRS
§§431:2-201, 431:3-302.5)

§16-185-115 Management's report of internal control over financial reporting. (a) Every insurer required to file an audited financial report 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 16-185-102[~~-~~] , Hawaii Administrative Rules. The report shall be filed with the commissioner along with the communication of internal control related matters noted in an audit described under section 16-185-110[~~-~~] , Hawaii Administrative Rules. Management's report of internal control over financial reporting shall be as of the December 31 immediately preceding.

(b) Notwithstanding the premium threshold in subsection (a) the commissioner may require an insurer to file management's report of internal control over financial reporting if the insurer is in any risk-based capital level event, as defined in [~~HRS~~] section 431:3-401, HRS, or meets any one or more of the standards of an insurer deemed to be in hazardous financial condition as defined in [~~HRS~~] section 431:15-103.5[~~-~~] , HRS.

- (c) An insurer or a group of insurers that is:
- (1) Directly subject to section 404;
 - (2) Part of a holding company system whose parent is directly subject to section 404;
 - (3) Not directly subject to section 404 but is a SOX compliant entity; or
 - (4) 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's 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 16-185-104(2) through (7), Hawaii Administrative Rules, were included in the scope of the section 404 report. The addendum shall be a positive statement by management that there are no material processes with respect to the preparation of the insurer's or group of insurers' audited statutory financial statements excluded from the section 404 report. If there are internal controls of the insurer or group of insurers that have a material impact on the preparation of the insurer's or group of insurers' audited statutory financial statements and those internal controls were not included in the scope of the section 404 report, the insurer or group of insurers may either file a report required by this section, or the section 404 report and this section's report for those internal controls that have a material impact on the preparation of the insurer's or group of insurers' audited statutory financial statements not covered by the section 404 report.

(d) Management's report of internal control over financial reporting shall include:

- (1) A statement that management is responsible for establishing and maintaining adequate internal control over financial reporting;
- (2) A statement that management has established internal control over financial reporting and an assertion, to the best of management's knowledge and belief, after diligent inquiry, as to whether its internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles;

- (3) A statement that briefly describes the approach or processes by which management evaluated the effectiveness of its internal control over financial reporting;
- (4) A statement that briefly describes the scope of work that is included and whether any internal controls were excluded;
- (5) Disclosure of any unremediated material weaknesses in the internal control over financial reporting identified by management as of the 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;
- (6) A statement regarding the inherent limitations of internal control systems; and
- (7) Signatures of the chief executive officer and the chief financial officer or equivalent position or title.

(e) Management shall document and make available upon financial condition examination the basis upon which its assertions required, in subsection (d), 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. Additionally:

- (1) 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; and
- (2) Management's report on internal control over financial reporting, required by subsection (a) and any documentation provided in

support thereof during the course of a financial condition examination, shall be kept confidential by the insurance division. [Eff 2/04/10; am and comp] (Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5, 431:3-401, 431:15-103.5)

§16-185-116 Exemptions and effective dates. (a)

Upon written application of any insurer, the commissioner may grant an exemption from compliance with any or all provisions of this chapter if the commissioner finds, upon review of the application, that compliance with this chapter 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 days from a denial of an insurer's written request for an exemption from this chapter, the insurer may request in writing a hearing on its application for an exemption. The hearing shall be held in accordance with section 431:2-308, HRS.

(b) Domestic insurers retaining a certified public accountant on the effective date of this chapter who qualify as independent shall comply with this chapter for the year ending December 31, 2010, and each year thereafter unless the commissioner permits otherwise.

(c) Domestic insurers not retaining a certified public accountant who qualifies as independent on the effective date of this chapter may meet the following schedule for compliance unless the commissioner permits otherwise:

- (1) As of December 31, 2010, file with the commissioner an audited financial report; and
- (2) For the year ending December 31, 2010, and each year thereafter, such insurers shall

file with the commissioner all reports and communication required by this chapter.

(d) Foreign insurers shall comply with this chapter for the year ending December 31, 2010, and each year thereafter, unless the commissioner permits otherwise.

(e) The requirements of section 16-185-106(d), Hawaii Administrative Rules, shall be in effect for audits of the year beginning January 1, 2010, and thereafter.

(f) The requirements of section 16-185-113, Hawaii Administrative Rules, are to be in effect January 1, 2010. An insurer or group of insurers that is not required to have independent audit committee members or only a majority of independent audit committee members, as opposed to a super majority, because the total written and assumed premium is below the threshold and subsequently becomes subject to one of the independence requirements due to changes in premium, shall have one year following the year the threshold is exceeded, but not earlier than January 1, 2010, or the effective date of this section, whichever is later, to comply with the independence requirements. Likewise, an insurer that becomes subject to one of the independence requirements as a result of a business combination shall have one calendar year following the date of acquisition or combination to comply with the independence requirements.

~~[(g) Sections]~~ (g) (1) Except for risk retention captive insurers, sections 16-185-101 through [118, except for section 16-185-113,] 112, and sections 16-185-114 through 118, shall be effective beginning with the reporting period ending December 31, 2010, and each year thereafter; ~~[except that sections]~~

(2) Sections 16-185-101 through [118,] 112, and sections 16-185-114 through 16-185-118, Hawaii Administrative Rules, shall be effective for risk retention captive insurers beginning with the reporting period ending December 31, 2011, and each year thereafter.

(3) Section 16-185-113.1, Hawaii Administrative Rules, shall be effective January 1, 2020. If an insurer or a group of insurers that is exempt from the section 16-185-113.1, Hawaii Administrative Rules, requirements no longer qualifies for that exemption, it shall have one year after the year threshold is exceeded to comply with the requirements of this chapter. [Eff 2/04/10; am and comp] (Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:2-308, 431:3-302.5)

§16-185-117 Canadian and British companies. (a)

In the case of Canadian and British insurers, the annual audited financial report shall be defined as the annual statement of total business on the form filed by such companies with their supervision authority duly audited by an independent chartered accountant.

(b) For such insurers, the letter required in section 16-185-105(b), Hawaii Administrative Rules, shall state that the accountant is aware of the requirements relating to the annual audited financial report filed with the commissioner pursuant to section 16-185-103, Hawaii Administrative Rules, and shall affirm that the opinion expressed is in conformity with those requirements. [Eff 2/04/10; comp] (Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5)

§16-185-118 Severability provision.

If any section or portion of a section of this chapter or its applicability to any person or circumstance is held invalid by a court, the remainder of the chapter or the applicability of the provision to any other person or circumstance shall not be affected." [Eff 2/04/10; comp] (Auth: HRS §431:2-201) (Imp: HRS §§431:2-201, 431:3-302.5)

2. Material, except source notes and other notes, to be repealed is bracketed and stricken. New material is underscored.
3. Additions to update source notes and other notes to reflect these amendments and compilations are not underscored.
4. These amendments to and compilation of chapter 16-185, Hawaii Administrative Rules, shall take effect ten days after filing with the Office of the Lieutenant Governor.

I certify that the foregoing are copies of the rules, drafted in the Ramseyer format pursuant to the requirements of section 91-4.1, Hawaii Revised Statutes, which were adopted
on _____ and filed with the
Office of the Lieutenant Governor.

CATHERINE P. AWAKUNI COLÓN
Department of Commerce and Consumer
Affairs

APPROVED AS TO FORM:

Deputy Attorney General