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*This is the third of a series of articles, the objectives of which are to share experiences from some of the early implementation efforts by state insurance departments with the NAIC's risk-focused examination approach; to consider emerging issues and their implications going forward; and to shed some light on future challenges as an increasing number of examiners from more states take the plunge with the new approach.*

## **Risk-Focused Examinations: Lessons Learned, Part 3 – Using the Work of Others**

State insurance examiners have known for many years that there may be certain advantages to their use of others' work in the conduct of regulatory examinations of insurance companies. In that context, "others" typically included both independent accounting firms and internal auditors, inasmuch as their work often covered many of the same aspects of an insurer as would likely be explored by a regulatory examination. Examiners had intended to achieve efficiencies by somehow leveraging the results of others' prior work, i.e., their knowledge, reports, and documentation. Nonetheless, some examiners may attest from their own experiences that such hoped-for efficiencies were elusive due to their perceptions of deficiencies in that prior work of others.

But times are changing. There is much new work that is being performed by "others" a large part of which is the result of changes wrought by the Sarbanes-Oxley Act of 2002 (SOX), which applies to public companies. Also, the NAIC now has a new Annual Financial Reporting Model Regulation (AFRMR) that includes new internal control-related requirements for larger insurers, both public and non-public. An exhibit follows that summarizes the key SOX provisions of relevance from an internal control and audit perspective, comparing those to the corresponding provisions of the AFRMR.

Furthermore, examiners themselves are beginning to contend with new Risk-Focused Examination guidance promulgated by the NAIC and which provides a very new context for the use of work of others. So, it is an apt time for examiners to revisit what may seem like a staid topic for the benefit of some fresh insights and value added to an examination.

## A Historical Perspective

The notion that examiners might benefit from the use of others' work was borrowed from the auditing profession. The AICPA adopted Statement on Auditing Standards (SAS) # 9 in the early 1980s in response to the emerging importance of internal audit environments at many companies. SAS #9 was superseded in 1991 by SAS 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*. SAS 65 provided that:

- The auditor should obtain an understanding of the internal audit function.
- If the auditor decides that it would be efficient to consider how the internal auditors' work might affect the nature, timing, and extent of audit procedures, the auditor should assess the competence and objectivity of the internal audit function. Guidance was provided as to how auditors would make that assessment.
- The internal auditor's work may affect the nature, timing, and extent of the audit, including procedures the auditor performs when obtaining an understanding of the entity's internal control, when assessing risk and in substantive procedures the auditor performs.

In the early 1990s, the NAIC developed what was then a new version of its Financial Condition Examiners Handbook. The new methodology became known to many as the "SRA Approach" because its foundation was a series of Specific Risk Analyses that were performed to derive the examination procedures to be performed. As part of that effort, the NAIC included new language in the Handbook regarding the work of internal auditors which, in many respects, mirrored the concepts of SAS 65. But they also took things one step further, recognizing that the work of the independent auditor was also something that examiners could better leverage in their examination of an insurer.

Through the 1990s, many examiners had mixed experiences with their efforts to comply with that guidance:

- Examiners increasingly were directed to use the work of the independent auditor, as suggested by the Handbook.
- They found that CPAs' working papers generally provided a centralized repository for at least some documentation about internal controls across many areas of the company.
- However, as years went by, that documentation appeared to become increasingly out of date, sparse, and/or otherwise inadequate for the examiners' use; as examiners gained experience with internal control information, they realized that the overall quality of such information in CPAs' working papers varied greatly.
- As a result, many examiners became increasingly critical of the work performed by independent auditors.

A possible irony is that the CPAs' working papers became a proxy for internal control information of the insurer itself. In retrospect, it might have been better for examiners to have ignored what was in the CPA's working papers and to instead request clear and

coherent control documentation directly from the company. Had they done so, they may have realized another and possibly much more ominous problem – that in many companies, the topic of internal controls was simply a low priority of senior management.

With the passage of SOX and the frenzy of attention that accompanied both the new law and the high-profile financial scandals that prompted it, change was on the way. SOX was adopted mid-2002, and by early 2005 the first reporting on internal controls pursuant to SOX was made by larger public companies, or “accelerated filers.”

## **The Impact of SOX**

While much has been said about the benefits and costs of SOX, there also have been certain developments of relevance to examiners in the context of their intent to better use the work of others. Prior to SOX, it may not have been unusual for an examiner to receive five different answers from five responsible people in the same area of an insurer as to what exactly the key controls were over a specific business process or activity. If you asked that question today, each of those people would likely have access to an internal control documentation database and could recite specifically those controls deemed as key *by the company* and access supporting documentation and the most recent testing results.

While the working papers of independent auditors have likely improved as well in the post-SOX era, the most fundamental change for examiners to consider is that the best, most complete and most current information should now be resident with the company itself, not its independent auditor. In the past, examiners would likely start with the CPA’s working papers to obtain an overall understanding of the company and information about internal controls and the nature of audit work performed. Now the primary source should be the company itself, and that is where the examiner’s attention should be first directed. When examiners have gained an understanding of the company and how the company approached its SOX documentation efforts, they will likely then find that the independent auditor’s work is logically structured to dovetail with the approach and content used by the company. That result is of no mere coincidence; to keep projects and costs manageable, companies and their auditors strive to be in sync as to the overall scope, methodology and approach taken.

Another nuance resulting from SOX is that it effectively expanded the population of “others” whose work could be considered for use by examiners. While in the past “others” had included internal and external auditors, now that term may also refer to management and employees as well as certain third parties who provide evidence of control effectiveness. For example, various “process owners” at companies must now attest to the soundness of processes and the effectiveness of controls. While internal audit departments initially led the way in performing testing on behalf of management, now that several years have passed, the work is migrating over to the process owners and their staffs with internal audit returning to a more traditional independent testing role and to operational audits. Likewise, companies may have others involved who, through

contractual arrangements, are involved in handling processes or the documentation and testing of related controls.

## **The Risk-Focused Examination Approach**

A couple of years ago, the NAIC adopted another new examination approach, this one referred to as the Risk-Focused Approach. Key components of the new approach include:

- A stronger focus on understanding the company
  - Top-down perspective
  - Better integration of analysis with the exam function
  - C-Level interviews
  - Possible need for Board /Audit Committee member interviews
- Deeper/broader focus on:
  - Strategy
  - Governance
  - Enterprise-wide controls
  - Risk management/ERM
  - Audit Function
  - A broad array of risks, including prospective risks

Gaining an understanding of the company and examination planning is the largest part of the risk-focused examination effort.

Of critical importance is to observe that these areas also relate to SOX. As a consequence, the examiner can expect that risk assessments have been performed by companies and by their independent auditors. The examiners' focus now can start there. What makes this company tick? What risks does it face? Is governance adequate? Is management adequate? Is risk management adequate? And is there evidence of that across a sufficient sample of activities of importance to allow the examiner to conclude that the enterprise-wide controls are effective?

To underscore this new and more important context, the revised Handbook includes sections on *Assessing the Adequacy of the Audit Function* which probes the effectiveness of the audit function, both the internal audit and external audit roles. These are no longer separate or disparate objectives unto themselves, but key components of more fundamental enterprise-wide controls that should be the subject of strong oversight by an independent audit committee of the board of directors.

The Handbook also poses tactical guidance for using the work of CPAs that otherwise is similar to that under the former SRA approach. The examiner should understand the auditor's risk assessment and audit approach. Exactly what response the examiner provides – to rely on the independent auditor's work, to ignore it, or to rely with testing – will depend on the risk, materiality, and subjectivity associated with the specific area.

The NAIC has adopted new guidance that provides the ability for examiners to use working papers of the CPA from the year prior to that actually under examination. This may have some advantage, particularly for states that want to use the concepts in the new approach to get a head start and accelerate the exam process. For example, for an exam as of the end of 2008, examiners may want to begin their work in the fall of 2008 by performing the C-Level interviews and risk assessment phases. But if they did so, the CPA's working papers on the 2008 audit would not likely be available until May or June of 2009. With the new guidance, examiners can instead review the prior year (2007) audit working papers, but they would need to perform inquiry and/or some degree of testing to gain assurance that the processes and controls have not changed during the course of the year subject to examination.

## **SOX and Internal Controls – a Moving Target**

It is useful to understand what SOX does, and does not, require management to do with regard to internal controls. The most pertinent section for purposes of this discussion is §404, the entire text of which follows:

**SEC. 404. MANAGEMENT ASSESSMENT OF INTERNAL CONTROLS.**  
(a) **RULES REQUIRED** – The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) to contain an internal control report, which shall—  
    (1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and  
    (2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.  
(b) **INTERNAL CONTROL EVALUATION AND REPORTING.**—With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

With such brief language, it may be hard for many to understand why there was such a contentious debate as to the need for §404 in the first place. But like other things, the devil was in the details. While industry groused about SOX§404 provisions and the cost of compliance, those complaints largely fell on deaf ears until the spring of 2005, following the first wave of filings with the SEC by accelerated filers. That is when the SEC and the PCAOB held a joint roundtable to debrief from these early experiences of SOX§404 implementation. They concluded that the effort was indeed beneficial, but also unnecessarily costly. In particular, they cited the following:

- Huge start-up costs were incurred.

- Excessive, duplicative or mis-focused efforts were made by companies and/or their auditors.
- A mechanical, overly-cautious, one-size-fits-all approach was used to attain maximum coverage, thus driving costs up.
- Companies had lacked guidance of their own and had to rely on audit firms for interpretations that were, in turn, based on guidance for the CPAs themselves.
- Management and auditors alike feared that simply discussing issues with each other might compromise the auditor's independence.
- "Primary evidence" language caused auditors to discount, rather than use, the work of others.

In May of 2005, interim guidance was issued both by the U.S. Securities and Exchange Commission (SEC, applicable to issuers) and by the Public Company Accounting Oversight Board (or PCAOB, applicable to auditors) in response to findings of the roundtable. The feedback from the roundtable and the interim guidance eventually culminated in the PCAOB's Auditing Standard No. 5 which superseded its Auditing Standard No. 2 effective for audits of fiscal years ending on or after November 15, 2007. Some of the more significant changes of Auditing Standard No. 5 include the following:

- The PCAOB's guidance for auditors and the SEC's guidance for registrants as to definitions of material weakness, significant deficiency, and entity-level controls are now consistent.
- It calls for a top-down approach versus an identification of major classes of transactions and significant processes.
- Fraud-related controls, with an emphasis on management fraud, are now considered more critical.
- More guidance is included on entity-level controls and how they can reduce the auditor's testing of other controls.
- There is better focus on the objectives of walk-throughs to understanding the likely sources of misstatement and the selection of controls to test.
- The approach is intended to be scalable to smaller companies.

Auditing Standard No. 5 also adopted the SAS 65 provisions for use on integrated audits of issuers, i.e., in situations where the objective is to audit both internal controls as well as the financial statements. Specifically, the auditor may use the work performed by, or direct assistance from, internal auditors, other company personnel, and/or third parties working under the direction of management or the audit committee. The higher the auditor's assessment of the level of competence and objectivity of these others, the more use the auditor may make of their work. Much also depends on the control being tested, e.g., the higher the risk, the more work the auditor should perform.

## **SOX at Insurers – What it Can Mean for Examiners**

At many publicly-traded insurers, the implementation of SOX§404 resulted in very real implementation challenges. The scope of the effort was across the entire organization,

and required an extraordinary degree of planning and coordination. Many large companies established a Project Management Office, or “PMO,” comprised of full-time dedicated staff to develop and deploy an implementation plan, monitor progress, and report to management and the audit committee as to ongoing progress, issues and problems, and the status of remediation or corrective efforts.

To accomplish its tasks, the PMO, with support from senior management, had to obtain resource commitments from business units and functional areas across the enterprise; provide training and supervision; develop the methodologies and tools to facilitate consistent high-quality results by all; and put testing and monitoring procedures and protocols in place. But did all of that change the control environment very much for insurers? The better companies would probably say no, that they had adequate controls in place all along. But even they would likely acknowledge:

- They now have better consistency and quality across the organization as to the identification, documentation and testing of key controls.
- Key controls and related documentation are more up-to-date and challenged on a basis that is more intense and frequent than before.
- There is a more independent review/testing function in place.
- The use of common tools across the enterprise has enhanced the process with respect to work-flow and methodology, making the information more centralized and more accessible and understandable to a much wider group of people throughout the organization.
- There is a better understanding and sharing of best practices across the organization.

Most importantly, the resulting information is actually *used* on a more current basis and is better understood by a broader group of people who have a need to understand what it says and the resulting implications – *which can now include examiners*. Ideally, examiners will be able to obtain on-line (read-only) access to the company’s internal control documentation system, which would include access to the company’s risk assessment, control descriptions and testing results. Numerous proprietary systems are now available on the market and which typically include a means to capture, share, and report information such as the following:

- Process name; owner(s); scope, including locations and functionality
- Description/overview – what it does and how
- Process and/or application flowcharts and narratives
- Examples of key documents
- Inputs, processing or actions, and outputs
- Who does what; evaluation of segregation of duties
- Relationship of automated versus manual controls and procedures
- Risks and corresponding assessments
- Key controls: frequency; assertions addressed; owner; assessments
- Narrative of an independent “walk-through” of the process
- Testing results and supporting documentation or references
- Financial statement accounts affected

- Measures of materiality: volumes and amounts
- Significant applications
- Non-key controls
- Document revision history; sign-offs

Some companies initially used their SOX§404 process to amass as much information as could be found regarding their internal controls. However, most companies are now being much more selective, identifying only those controls that are truly key and the minimum information about them to satisfy their responsibilities under SOX. In doing so, they can better control the cost of the effort and focus the work of their external auditor, and perhaps reduce their exposure if extraneous information elsewhere might somehow conflict with that which is in their SOX§404 database. That means that examiners may find that not all controls are identified and subjected to the documentation, testing and reporting rigor as those “key controls” that are deemed by the company as sufficient to support its assertions under SOX§404.

Another nuance that examiners may have to get used to is the very likely possibility that even every key control may not be tested, or at least not in every period. Audit guidance allows the auditors to gain comfort on a testing strategy whereby a subset of controls may be tested currently. For example, and for a particular area, the auditors may test 75% of those key controls where more subjectivity and judgment is involved, and only 50% or so of other controls that are more routine and automated. Thus, in using the auditor’s work, the examiners will need to obtain their own degree of comfort with that approach and/or supplement the auditor’s work with additional testing of their own.

## **Other Considerations**

Some other considerations for examiners to ponder about the use of others’ work in the conduct of examination include the following:

- Examiners may have a better/faster approach for testing than to use the work of others, e.g., certain Jumpstart applications, or the use of I-Site Profiles for analytical review and peer comparisons.
- The work of others may not directly apply to the examiners’ focus on statutory reporting, such as with respect to deferred acquisition costs. Nonetheless, some GAAP information may shed light on other statutory accounting issues, e.g., DAC recoverability issues for GAAP may imply pricing problems and prospective risks.
- SAP-specific items are not likely covered by SOX testing, but they should be covered in the independent auditor’s audit of the statutory-basis financials of the insurer legal entity. Examples may include support of amortized cost of bonds, AVR/IMR, and certain SAP life reserves. Nonetheless, some exam objectives (e.g., existence, completeness and cutoff, ownership and obligation) will probably be covered by SOX testing of GAAP reporting. Other exam objectives may not be tested as part of SOX as they specifically pertain to SAP reporting (e.g., valuation, compliance, presentation and disclosure).

- Some SAP accounting provisions may lessen risk and the extent of testing required, e.g., the existence of AVR provides a cushion for impairments that doesn't exist for GAAP.
- Adequate testing may have already been performed by others at the Insurance Department, e.g., with respect to the review of compliance with investment limitations which may have been reviewed in detail by the Department's in-house analysts.
- Areas may not be covered by SOX, either because they are out-of-scope or immaterial on a consolidated basis, but which may nonetheless be of significance to the specific legal entity under examination. However, the NAIC's Annual Financial Reporting Model Regulation (discussed below) should lessen such occurrences.
- All risks that are covered by the NAIC's risk-focused approach are not necessarily covered by SOX, which focuses on financial reporting. Additional areas of importance to examiners therefore may not be covered, e.g., certain compliance matters.

Before diving into the work of others, it is helpful if the examiner first has made sufficient inquiries of company executives and review of other documents to form a preliminary view about the company and its risks. A discussion then with the internal or external auditor, as the case may be, should then help to clarify or confirm the examiner's understanding, and perhaps highlight issues about which the examiner was not previously aware.

In reviewing working papers, it may be helpful to perform the review in several iterations, as follows:

- Make a first, high-level pass to glean an overview as to the working papers, their structure and the key areas covered, adjustments made or passed, and opinions and recommendations.
- Understand the nature of the risk assessment that was performed, and how the audit scope was determined.
- Determine the nature and extent of work performed involving enterprise-wide controls and the auditor's assessment of their effectiveness.
- For key financial activities of significance to the examiner, understand the nature, timing and extent of the auditor's procedures; where practical, relate that to the work performed by the company in its self-testing of key controls and note as evidence of testing in the risk matrix.

With this information, and with input from other phases of the examination process, the examiner would then complete the risk matrix including the examination procedures to be performed. In areas where risk is lower, it may be appropriate to rely on the work of others with no additional testing. In other areas, the examiner would consider the need for supplemental testing, e.g., to re-test items previously tested by the auditor, to independently test other items but in a similar manner, or to perform procedures in addition to those performed by the auditor.

## **Impact of the NAIC's Annual Financial Reporting Model Regulation**

Insurers that are not subject to the SOX§404 requirements may nonetheless soon come under the internal control reporting requirements of the NAIC's Annual Financial Reporting Model Regulation (AFRMR). The NAIC hopes that this new model will be enacted by all states in a uniform fashion, effective with the reporting period ending December 31, 2010. The AFRMR requires a report by management on internal controls by all insurers with annual premiums in excess of \$500 million. Insurers that are "SOX Compliant" can file their SOX-based internal control reports with their state of domicile; however an "Addendum" would be required to address legal entity or SAP-specific items that may not be addressed by SOX-based reporting which is focused on consolidated GAAP-basis financial statements. An external auditor attestation on the internal control reports is not required by the AFRMR.

A key provision of the AFRMR is that "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." Thus, management has some flexibility as to the frequency and scope of testing activities and the documentation to be provided upon examination. Nonetheless, no clear descriptions or examples are provided in the AFRMR or the Implementation Guide as to what an alternative IC framework might look like or how it may differ from COSO or other established frameworks.

While the AFRMR applies only to companies with premiums over \$500 million, examiners may very well find that some smaller companies have voluntarily adopted certain measures not unlike those of SOX or the AFRMR as they relate to auditor independence, governance, or internal controls.

### **Conclusion**

There is much that is new in the work of others that examiners can consider and leverage in the conduct of regulatory examinations of insurers. Examiners should give that work a fresh look, especially in the context of the new risk-focused examination approach.

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*The author plans to continue sharing lessons learned about the risk-focused examination approach in subsequent editions of *The Examiner*, and welcomes SOFE members to submit other lessons learned for consideration for discussion in further articles on a no-attribution basis. You can submit your "lessons learned" in an e-mail to the author, at [tfinnell@invotex.com](mailto:tfinnell@invotex.com).*

## Comparison of Key Title II, III and IV SOX Provisions to the NAIC's Annual Financial Reporting Model Regulation

Sarbanes Oxley Act of 2002 (SOX)	Annual Financial Reporting Model Regulation Provisions	
	Comparison to SOX	Exemptions, Waivers, or Exceptions
Title II – Auditor Independence		
<p>Sec. 201 – Bans auditors from providing the following services to their public audit clients: Bookkeeping or other services to prepare the financial statements; financial information systems design and implementation; appraisal or valuation services, fairness opinions, or contribution-in-kind reports; actuarial services; internal audit outsourcing services; management functions; human resources/executive recruiting services; broker/dealer, investment advisor, or investment banking services, legal/expert services unrelated to the audit, and other services determined by the SEC or the PCAOB to be impermissible.</p>	<p>Sec. 7G – Incorporates similar prohibitions as SOX Sec. 201.</p> <p>For actuarial services, clarifies that the prohibition relates to the determination of amounts recorded in the financial statements.</p> <p>Key principles: the auditor can't function in the role of management; audit his or her own work; or serve in an advocacy role for the insurer.</p>	<p>The accountant's actuary may also issue an actuarial certification or opinion if certain conditions have been met.</p>

*Readers are encouraged to read the NAIC's Annual Financial Reporting Model Regulation in its entirety, including drafting notes and the corresponding Implementation Guide.*

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Sarbanes Oxley Act of 2002 (SOX)	Annual Financial Reporting Model Regulation Provisions	
	Comparison to SOX	Exemptions, Waivers, or Exceptions
Title II – Auditor Independence (cont'd)		
<p>Sec. 202 – All auditing and non-auditing services provided to a public company by the independent auditor must be approved in advance by the audit committee, or be approved pursuant to pre-approval policies and procedures enacted by the audit committee.</p>	<p>Sec. 7I – Incorporates a similar pre-approval requirement as SOX Sec. 202.</p>	<p>The requirement is waived for “SOX Compliant Entities” and their wholly-owned subsidiaries. It is also waived if the aggregate amount of non-audit services is no more than 5% of the total amount of fees paid by the insurer to the independent auditor and if other criteria are met.</p> <p>Insurers having direct written and assumed premiums of less than \$100 million in any calendar year can request an exemption on the basis of a financial or organizational hardship.</p>
<p>Sec. 203 – The lead audit partner and the audit partner responsible for reviewing the audit must rotate off the audit every five years. (SEC guidance extends this further to include other partners in addition to the lead and concurring partner; such other partners could serve no longer than seven years then be off the engagement for two years)</p>	<p>Sec. 7D – The lead, or coordinating, partner may not act in that capacity for more than five consecutive years, then must rotate off for five years.</p>	<p>An insurer may apply to the commissioner for relief on the basis of unusual circumstances. If relief is granted, the insurer shall file such with its annual statement filing.</p>

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Sarbanes Oxley Act of 2002 (SOX)	Annual Financial Reporting Model Regulation Provisions	
	Comparison to SOX	Exemptions, Waivers, or Exceptions
Title II – Auditor Independence (cont'd)		
Sec. 204 – The auditor must report to the audit committee all critical accounting policies and practices; all alternative accounting treatments that had been discussed with management; and other written communications that are material to the financial statements, e.g., management letters and schedule of unadjusted differences.	Sec. 14F – Contains language similar to SOX Sec. 204.	
Sec. 206 – Precludes a public company from hiring an employee of their audit firm as CEO, controller, CFO, chief accounting officer or equivalent until after a one-year cooling off period. Implementation guidance expands this to anyone in a financial oversight role.	Sec. 7L – Contains similar provision, but only applies to partners or senior managers involved in the audit.	Insurers can apply for relief from this provision on the basis of unusual circumstances. If relief is granted, such shall be filed in the company's Annual Statement.

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Sarbanes Oxley Act of 2002 (SOX)	Annual Financial Reporting Model Regulation Provisions	
	Comparison to SOX	Exemptions, Waivers, or Exceptions
<b>Title III – Corporate Responsibility</b>		
<p>Sec. 301 – Establishes minimum audit committee requirements. The audit committee must:</p> <ul style="list-style-type: none"> <li>• Be comprised of independent members</li> <li>• Be responsible for appointing, compensating, and overseeing the work of the audit firm, who must report directly to the committee</li> <li>• Accommodate confidential hotlines for employees to report questionable accounting or auditing matters</li> <li>• Have authority to engage independent legal counsel and have adequate funding.</li> </ul>	<p>Sec. 14 –The proportion of independent audit committee members must be at least:</p> <ul style="list-style-type: none"> <li>• 75% for companies with over \$500 million of calendar year direct and assumed premiums</li> <li>• 50% if premiums are between \$300 million and \$500 million</li> <li>• No minimum requirement if premiums are less than \$300 million</li> </ul> <p>The audit committee of a holding company can be deemed to be the audit committee for controlled insurers at the election of the controlling person.</p>	<p>Does not apply to “SOX Compliant Entities” or their wholly-owned subsidiaries.</p> <p>With approval, or as required by law, otherwise non-independent members may participate in the audit committee and be designated as independent, unless they are an officer or employee of the insurer or one of its affiliates.</p> <p>Intended to take effect January 1, 2010; transition rules apply as companies cross the \$300/\$500 million premium triggering thresholds. Insurers with &lt; \$500 million of direct and assumed premiums (as defined) can apply for hardship waiver.</p>

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Sarbanes Oxley Act of 2002 (SOX)	Annual Financial Reporting Model Regulation Provisions	
	Comparison to SOX	Exemptions, Waivers, or Exceptions
<b>Title III – Corporate Responsibility</b>		
Section 303 – Makes it unlawful for officers and directors of an issuer, or others acting under their direction, from coercing, manipulating, misleading, or fraudulently influencing the auditor if they knew or should have known that such action could render the financial statements misleading.	Sections 15A-C – Provides requirements similar to SOX Sec. 303.	
<b>Title IV—Evaluation of Internal Controls</b>		
Section 404 – Management must report annually on the effectiveness of the company’s internal control over financial reporting.	<p>Management has discretion as to the nature of the internal control framework used and related documentation so as to be cost effective in its efforts.</p> <p>Management report to include unremediated material weaknesses as of the prior year-end. Significant deficiencies are not required to be reported, but such information may be requested as part of an examination.</p>	Insurers/groups subject to SOX§404 or who otherwise are a “SOX Compliant Entity” may file its or its parents “Section 404 Report” (as defined by the SEC), provided the key internal controls of the insurer are included in the scope of that Section 404 Report. If some key controls were omitted in the Section 404 Report, the insurer would also have to file a MAR Section 16 report covering those key controls.

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Sarbanes Oxley Act of 2002 (SOX)	Annual Financial Reporting Model Regulation Provisions	
	Comparison to SOX	Exemptions, Waivers, or Exceptions
Title IV—Evaluation of Internal Controls (cont'd)		
The company's independent auditor must attest to and report on management's assertion.	No provision for an independent audit report on internal controls or on management's assertion.	
Both management's internal control report and the auditor's report must be included in the company's annual report filed with the SEC.	Management's internal control report would be filed with the commissioner.	
The SEC adopted transition period rules that delayed the effective date. "Accelerated filers", i.e., those registrants with public equity float in excess of \$75 million were required to be in compliance for fiscal years ending on or after June 15, 2004.		Would apply to insurers with direct written and assumed premium in excess of \$500 million. Nonetheless, the commissioner can require other companies to comply if they are in a RBC action level event or are deemed to be in hazardous financial condition.

*Readers are encouraged to read the NAIC's Annual Financial Reporting Model Regulation in its entirety, including drafting notes and the corresponding Implementation Guide.*