

Government of Puerto Rico
OFFICE OF THE COMMISSIONER OF INSURANCE
San Juan, Puerto Rico

RULE NO. 14-A

AUDITED FINANCIAL STATEMENTS

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RULE NO. 14-A AUDITED FINANCIAL STATEMENTS

SECTION 1. STATUTORY GROUNDS

The Office of the Commissioner of Insurance of Puerto Rico (hereinafter the OCI or Commissioner) hereby repeals Rule 14-A of the Regulations of the Insurance Code of Puerto Rico, Regulation 7958, as filed at the Department of State, currently in effect, and adopts a new Rule 14-A, "Audited Financial Statements", under the authority vested by the provisions of Section 2.030 of Act No. 77, enacted on June 19, 1957, as amended, known as the Insurance Code of Puerto Rico, as well as the provisions of Act No. 38, enacted on June 3, 2017, as amended, the Uniform Administrative Procedure Act of the Government of Puerto Rico.

This Rule is adopted in accordance with the most recent version of the model regulation number 205 titled "Annual Financial Reporting Model Regulation" of the National Association of Insurance Commissioners (NAIC).

SECTION 2. PURPOSE AND SCOPE

The purpose of this Rule is to strengthen and complement the surveillance system of the operations and financial solvency of domestic authorized insurers by requiring: (1) an annual audit of financial statements reporting the financial condition 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) a Management's Report of Internal Control Over Financial Reporting to be filed with the OCI.

Each insurer, as defined in Section 4, shall be subject to the provisions of this Rule. Insurers having written less than one million dollars (\$1,000,000) in direct premiums during any calendar year and having fewer than one thousand (1,000) policyholders or certificate holders of written policies nationwide at the end of each calendar year, shall be exempt from this Rule for the current year, unless the Commissioner provides otherwise. Insurers having assumed premiums pursuant to reinsurance agreements or treaties of \$1,000,000 or more will not be exempt from the provisions of this Rule.

Foreign or alien insurers filing their audited financial reports in another State of the United States, pursuant to the filing requirements of that state, that the Commissioner finds are substantially similar to the requirements of this Rule, shall be exempt from

Sections 5 to 14, if they file with the OCI:

- A. A copy of the audited financial statement, the Communication of Internal Control Related Matters Noted in an Audit, and the Accountant's Letter of Qualifications that were filed with the other state, in accordance with the filing dates specified in Sections 5, 12, and 13, respectively. Canadian insurers must submit accountants' reports as filed with the Office of the Superintendent of Financial Institutions in Canada.
- B. A copy of any notification of adverse financial condition submitted in any other state, within the period of time specified in Section 11 of this Rule.

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 with the OCI, provided the Report filed in the other state includes similar requirements to those of Puerto Rico and the Report is filed with the Commissioner of the other state by the established deadline.

This Rule shall not prohibit, preclude or in any way limit the powers of the Commissioner of Insurance, to investigate and examine the operations of insurers, nor limit the practices and procedures established in the OCI pursuant to the Insurance Code of Puerto Rico.

SECTION 3. -STATEMENT OF NEED AND OBJECTIVE

As provided in the Insurance Code of Puerto Rico, insurers must file with the OCI an annual report on their financial condition and commercial transactions. specifically, Section 3.310 provides the following:

- (1) Each authorized insurer shall annually, before the thirty-first day of March, file with the Commissioner a true statement of its financial condition, transactions, and affairs as of the preceding December 31st. Said statement: shall be made on the forms as prescribed by the Commissioner; shall contain information as required by this title and by the Commissioner; and shall be verified by the oath of at least two of the insurer's principal officers. The annual statement of a reciprocal or Lloyd's insurer shall be verified by its attorney-in-fact.
- (2) The annual statement of a foreign insurer not formed in the United States but authorized to transact insurance in a state of the United States, may refer only to its assets, transactions, and affairs in the United States and Puerto Rico (and including, at the insurer's option, the Virgin Islands and the Canal Zone) unless the Commissioner requires otherwise. The statement may be verified by the insurer's United States manager or by its duly authorized officers.

- (3) The Commissioner may suspend or revoke the authority of any insurer failing to file its annual statement when due, or failing to file it during any extension of time therefor which the Commissioner may, for good cause, grant.

By adopting this Rule the OCI establishes the uniform standards used in the United States, as promulgated by the NAIC, to reinforce the oversight and supervision of the financial condition and solvency of insurance companies through the filing of an audited financial statement and documents related to the drafting thereof. The objective of regulating solvency is to ensure that insurance companies that operate in Puerto Rico have an adequate level of capital to meet their contractual obligations with the insured and claimants as required by law.

SECTION 4. DEFINITIONS

The following terms shall have the meanings set forth below, except when another meaning may be inferred from the context or any other provision of this Rule:

- A. An "affiliate" of, or person "affiliated" with, a specific person, means a person that directly, or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.
- B. "Section 404" - Means Section 404 of the Sarbanes-Oxley Act of 2002 and the Securities Exchange Commission" (SEC) regulations promulgated thereunder.
- C. "Insurer" - Is a person who is engaged in transacting insurance as defined in Section 1.050 of the Insurance Code of Puerto Rico. Without limiting the general meaning of the above definition, a reciprocal insurance association, mutual associations, a health services organization or groups of any kind, whether for profit or not, engaged in the business of executing insurance contracts, are insurers.
- D. "Insurance Code" - Means Public Law No. 77, enacted on June 19, 1957, as amended, known as the Puerto Rico Insurance Code.
- E. "Audit Committee" - Means a committee (or equivalent group) 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, and audits of financial statements of the insurer or group of insurers. The audit committee of any entity that controls a Group of insurers may be designated as the audit committee for one or more of these insurers. Refer to Section 15F for exercising this election. If an audit committee is not designated by the insurer, the insurer's entire board of directors shall constitute the audit committee.
- F. "Adverse Financial Condition" - Means the provisions of Rule 94 defining the

standards and authority of the Commissioner of Insurance with regard to insurers presenting an adverse financial condition.

- G. "Accountant" or "independent certified public accountant" - Means a certified public accountant or a firm of certified public accountants licensed to practice in the Commonwealth of Puerto Rico and who is a member of the Puerto Rico Certified Public Accountants Association (AICPA) and of the Certified Public Accountants Association of Puerto Rico. For Canadian or British companies, the terms mean a chartered accountant.
- H. "Internal control over financial reporting" means the process effected by an entity's board of directors, management and other designated personnel to provide reasonable assurance regarding the reliability of the financial reports, i e , those items specified in Section 6B through 6G of this Rule and includes those policies and procedures that:
- (a) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets;
 - (b) Provide reasonable assurance that the recording of transactions will permit the preparation of the financial reports, i.e., those items specified in Section 6B through 6G of this Rule and that the financial transactions have been made only in accordance with authorization of management and directors; and
 - (c) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, and use or disposition of assets that could have a material effect on the financial reports, i.e., those items specified in Section 6B through 6G of this Rule.
- I. "Sarbanes-Oxley Act (SOX) Compliant Entity" means an entity that either is required to be compliant with, or voluntarily is compliant with, the following provisions of the Sarbanes- Oxley Act of 2002:
- (i) the preapproval requirements of Section 201 (Section 10A(i) of the Securities Exchange Act of 1934);
 - (ii) the Audit committee independence requirements of Section 301 (Section 10A(m)(3) of the Securities Exchange Act of 1934); and
 - (iii) the Internal control over financial reporting requirements of Section 404 (Item 308 of SEC Regulation S-K).
- J. "Internal Audit Function": means a person or persons who provide independent, objective, and reasonable assurance designed to add value and improve an

organization's operations and accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and, governance processes.

- K. "Insurer's management" - Means the group of highly qualified employees in charge of directing and managing an insurer's affairs.
- L. " Group of insurers" - Means authorized insurers, included in the reporting requirements of Chapter 44 of the Insurance Code or as identified by management, for the purpose of assessing the effectiveness of Internal control over financial reporting.
- M. "Indemnification" means an agreement of indemnity or a release from liability for the purpose of modifying or limiting any kind of liability of a person or firm for failure to adhere to applicable auditing or professional standards, whether or not resulting from knowledge of misrepresentations made by the insurer or its representatives.
- N. "Section 404 Report" - Means management's report on internal control over financial reporting as defined by the SEC and the related audit report prepared by the independent certified public accountant as described in Section 4G.
- O. "Audited Financial Statements" - Means what is provided in Section 6.
- P. "Independent member of the Board" - Means what is provided in Section 15C.
- Q. "NAIC": means the National Association of Insurance Commissioners.
- R. "Receivership procedures" - Means any procedure established against an insurer for the purpose of liquidating or rehabilitating the insurer as provided in Chapter 40 of the Insurance Code.
- S. "SEC" - Means the US Securities and Exchange Commission).

SECTION 5. GENERAL REQUIREMENTS RELATED TO FILING AND EXTENSIONS FOR FILING OF ANNUAL AUDITED FINANCIAL REPORT AND AUDIT COMMITTEE APPOINTMENT

- A. All authorized insurers shall have an annual audit by an independent certified public accountant and shall file an Audited financial report with the OCI on or before June 1 for the year of operations ended December 31 immediately preceding. The Commissioner may require an insurer to file an audited financial report earlier than June 1, if notice is provided to the insurer ninety (90) days in advance.

- B. The OCI may grant extensions of time for the filing of audited financial reports for thirty (30) additional days, if the insurer and its independent certified public accountant show just cause. The request for extension must be submitted in writing not less than ten (10) days prior to the due date, with sufficient information to permit the Commissioner to make an informed decision with respect to the requested extension.
- C. If an extension is granted, a similar extension of thirty (30) days is granted for the insurer to file the Management's Report of Internal Control over the Audited Financial Statements.
- D. Every insurer required to file annual audited financial reports as described in this Rule shall designate a group of individuals to constitute an audit committee, as defined in Section 4. The audit committee of an entity that controls an insurer may be appointed as the insurer's audit committee for purposes of this Rule, at the time the controlling person is elected.

SECTION 6. CONTENT OF AUDITED FINANCIAL STATEMENTS

The annual audited financial reports shall describe the financial condition of the insurer, 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 OCI.

The audited financial reports shall include the following:

- A. Audit Report by the Independent Certified Public Accountant.
- B. Balance sheet reporting admitted assets, liabilities, capital, and surplus.
- C. Statement of income.
- D. Statement of cash flow.
- E. Statement of changes in capital and surplus.
- F. Notes to financial statements. These shall be those required by the appropriate NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual. The notes shall include a reconciliation of differences, if any, between the statutory audited financial report and the annual financial report filed with the OCI according to Section 3.310 of the Insurance Code, with a written description of the nature of these differences.
- G. The audited financial reports shall be prepared in a way that is substantially similar to the relevant sections for the annual report of the insurer filed with the OCI. In addition, the financial statement shall be comparative with the previous year. However, if it is the first year in which an insurer is filing such audited financial statement, the comparative data may be omitted.

SECTION 7. APPOINTMENT OF THE INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

- A. All authorized insurers required to file an annual audited financial report, within sixty (60) days after becoming subject to this Rule, must register with the OCI in writing the name and address of the independent certified public accountant or the audit firm that will conduct the annual audit required in this Rule. Insurers who have not retained an independent certified public accountant by the effective date of this Rule shall register the name and address of their retained independent certified public accountant not less than six (6) months before the date when the first audited financial report is to be filed.
- B. The insurer shall obtain a letter from the independent certified public accountant, and file a copy with the Commissioner, certifying that the accountant is aware of the provisions of the Insurance Code and regulations related to accounting and financial matters in the state of domicile. In addition, the letter shall indicate that the accountant will express an opinion on the audited financial statements according to the statutory accounting practices prescribed or otherwise permitted by the OCI.
- C. If the accountant who prepared the preceding audited financial reports is dismissed or resigns, the insurer shall within five (5) business days notify the OCI of this event. The insurer shall also furnish the Commissioner with a separate letter within ten (10) business days of the above five-day notification, stating whether in the twenty-four (24) 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 his or her opinion. The disagreements required to be reported include both those resolved to the former accountant's satisfaction and those not resolved to the former accountant's satisfaction. Disagreements contemplated by this section are those that occur at the decision-making level, i.e., between personnel of the insurer responsible for filing its financial statements and personnel of the accounting firm responsible for rendering the opinion. In addition, the insurer shall request in writing that the former accountant furnish a letter addressed to the insurer stating whether the accountant agrees with the statements contained in the insurer's letter to the Commissioner, and, stating the reasons for which he or she does not agree. The insurer shall furnish the former accountant's letter to the Commissioner together with its own.

SECTION 8. QUALIFICATIONS OF THE INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

- A. The Commissioner will not recognize an independent certified public accountant nor accept audited financial reports prepared either completely or partially by said accountant if the accountant:
- (1) Is not a member in good standing of the AICPA in the states where the accountant is authorized to practice or in the case of a Canadian or British company, who is not a chartered accountant; or
 - (2) Has executed, whether directly or indirectly, an indemnification agreement or release of liability with respect to the audit of the insurer.
- B. Except as otherwise provided in this Rule, the Commissioner shall recognize an independent certified public accountant as qualified as long as he or she conforms to the standards of his or her profession, as contained in the Code of Professional Ethics of the AICPA and Code of Professional Conduct of the Board of Public Accountancy of Puerto Rico and the Association of Certified Public Accountants of Puerto Rico, or any other similar code.
- 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 receivership proceeding commenced against the insurer under Chapter 40 of the Insurance Code, the mediation or arbitration provisions shall operate at the option of the receiver, whether it be for liquidation or rehabilitation.
- D.
- (1) The lead or coordinating audit partner having primary responsibility for the audit may not act in that capacity for more than five (5) consecutive years. The person 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 (5) consecutive years. An insurer may make application to the Commissioner for waiver of the above requirement on the basis of unusual circumstances, whether existent or newly arisen. This application should be made at least thirty (30) days before the end of the calendar year. The Commissioner may consider the following factors in determining if the waiver should be granted:
 - (a) Number of partners, expertise of the partners or the number of insurance clients in the registered firm;
 - (b) Premium volume of the insurer; or
 - (c) Number of jurisdictions in which the insurer transacts business.

- (2) Annually, the insurer shall file, with its financial statements, the approval for the waiver under Subsection D (1) in each state that it is licensed in or doing business in and with the NAIC. If the state accepts electronic filing, the insurer shall file the approval in an electronic format acceptable to the NAIC.
- E. The Commissioner will not recognize as an independent certified public accountant nor accept audited financial reports prepared either completely or partially 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; or
 - (2) Has been found to have violated insurance laws with respect to any previous report filed under this Rule; or
 - (3) Has shown a deficient pattern or practice in detecting or disclosing material information in previous reports filed under the provisions of this Rule.
- F. As provided in Section 2.190 of the Insurance Code, the Commissioner may hold an administrative hearing to determine if an Independent Certified Public Accountant is qualified and in consideration of the evidence submitted, may determine whether such accountant is qualified to give an opinion on the audited financial statements or may require that the insurer replace the accountant with another whose relationship with the insurer qualifies under this Rule.
- G.
 - (1) 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, an accountant who contemporaneously provides the insurer with the following services:
 - (a) Bookkeeping or other services related to the accounting records or financial statements of the insurer;
 - (b) Design and implementation of financial information systems;
 - (c) Appraisal or valuation services; opinions on fair prices, or reports on in-kind contributions;
 - (d) Actuarial consulting services related to determining the 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;
 - (iii) The accountant's actuary tests the reasonableness of the reserves after the insurer's management has determined the amount of the reserves;
- (e) Outsourcing internal audit service;
 - (f) Management or human resources functions;
 - (g) Broker, investment adviser, or investment banking services;
 - (h) Legal or expert services not related to the audit or
 - (i) Any other services that the Commissioner determines not permissible.
- (2) In general, the principles of independence with respect to services provided by the qualified independent certified public accountant are predicated on three basic principles: the accountant cannot function in the role of management, cannot audit his or her own work, and cannot serve in an advocacy role for the insurer. Any failure to follow any of these principles could impair the work of the independent certified public accountant.
- 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 (1). For this purpose, the insurer shall file with the Commissioner a written report, establishing the reasons why the insurer should be exempt from these provisions. If the Commissioner finds, upon review of this report, that compliance with this regulation would constitute a financial or organizational hardship upon the insurer, an exemption may be granted.
- I. An independent certified public accountant who performs an audit may engage in other non-audit services, including tax services, that are not described in subsection G (1) or that do not conflict with subsection G (2), only if the activity is approved in advance by the Audit committee, in accordance with subsection J.

- J. All auditing services and other services provided to an insurer by the independent certified public accountant of the insurer shall be preapproved by the Audit committee. The preapproval requirement will not apply with respect to non-audit services if the insurer is a SOX Compliant Entity or a direct or indirect wholly-controlled 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 percent (5%) of the total amount of fees paid by the insurer to its qualified independent certified public accountant during the fiscal year in which the non-audit services are provided;
 - (2) The services were not recognized by the insurer at the time of the agreement 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 of its members the authority to grant the preapprovals required in 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.
- L.
- (1) The Commissioner of Insurance 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 other 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 (1) year period preceding the date that the most current opinion is due. This section shall only apply to partners and senior managers involved in the audit. An insurer may make application to the Commissioner for a waiver from the above requirement on the basis of unusual circumstances.
 - (2) The insurer shall file, with its annual audited statements, the approval of the waiver of Subsection L (1) in the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

SECTION 9. CONSOLIDATED OR COMBINED FINANCIAL STATEMENTS

An insurer may make written application to the Commissioner for approval to file audited consolidated or combined financial statements in lieu of separate audited financial statements if the insurer is part of a group of insurers that utilizes a pooling or 100 percent 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 worksheet shall be filed with the audited financial statement, as follows:

- A. Amounts shown on the consolidated or combined audited financial statement shall be shown on the worksheet;
- B. Amounts for each insurer subject to this section shall be stated separately;
- C. Noninsurance operations may be shown on the worksheet on a combined or individual basis;
- D. Explanations of consolidating and eliminating entries shall be included; and
- E. 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 insurer.

SECTION 10. SCOPE OF THE AUDIT AND THE REPORT OF THE INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

The independent certified public accountant shall examine the financial statements that have been filed according to the provisions of Section 6. The audit of the insurer's financial statements shall be conducted in accordance with generally accepted auditing standards. In accordance with AU Section 319 of the Professional Standards of the AICPA, *Consideration of Internal Control in a Financial Statement Audit*, the independent certified public accountant should obtain an understanding of internal control sufficient to plan the audit. To the extent required by AU 319, for those insurers required to file a Management's Report of Internal Control Over Financial Reporting, as provided in Section 18 of this Rule, the independent certified public accountant should consider the independent certified public accountant should consider (as that term is defined in Statement on Auditing Standards (SAS) No. 102, *Defining Professional Requirements in Statements on Auditing Standards* or its replacement) the most recently available statements 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 as the independent certified public accountant deems necessary.

SECTION 11. NOTIFICATION OF ADVERSE FINANCIAL CONDITION

- A. Insurers required to file annual audited financial reports with the OCI must require the independent certified public accountant to notify, in writing, within five (5) business days to the Board of Directors and its Audit Committee, any finding of material misstatements of the financial condition of the insurer reported at the OCI or that the insurer failed to comply with the minimum capital and surplus requirements established in Section 3.090 of the Insurance Code as of that date. Insurers that receive a report under this paragraph shall deliver a copy of such report to the OCI within five (5) business days of the receipt of the report and shall provide the independent certified public accountant who prepared the report with evidence that the report was filed with the OCI. If the independent certified public accountant fails to receive such evidence within the required five (5) business days, the independent certified public accountant will forward to the OCI a copy of his report within the following five (5) 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 Subsection A if the statement is made in good faith in compliance with Subsection A.
- C. If the accountant, subsequent to the date on which the Audited financial report was filed pursuant to this Rule, becomes aware of facts that might have materially affected his or her report, the accountant must take the necessary action to make corrections, as prescribed in Volume 1, Section AU 561 of the Professional Standards of the AICPA.

SECTION 12. COMMUNICATION OF INTERNAL CONTROL MATTERS NOTED IN AN AUDIT

- A. In addition to the annual audited financial statement, each insurer shall file a written communication with the Commissioner describing material deficiencies, in respect to the internal controls, found during the audit. The communication shall be prepared by the accountant within sixty (60) days after the filing of the annual audited financial statements and contain a description of all material weakness that have not been corrected, material weaknesses being as defined in the Statement on Auditing Standard 60, Communication of Internal Control Related Matters Noted in an Audit, or the document that replaces such, as of the immediately preceding December 31 (to coincide with the audited financial statement described in Section 5(A)) on the internal controls of the insurer for financial reports observed by the accountant during the audit of the financial statements. If there are no material weaknesses, the written communication shall so state.

- B. Insurers are required to provide a description of remedial actions taken or proposed to correct unremedied deficiencies, if the actions are not described in the accountant's communication.

SECTION 13. INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT'S LETTER OF QUALIFICATIONS

Along with the annual audited financial statement, the accountant shall furnish the insurer a letter stating the following:

- A. That the accountant is independent of the insurer and complies with the professional standards as set forth in the Code of Professional Ethics and publications of the AICPA and the Rules of Professional Conduct of the Association of Certified Public Accountants of Puerto Rico or similar code;
- B. The accountant's background and experience in general, and the experience in audits of insurers of the staff assigned to the audit and whether each member of the staff is an independent certified public accountant. No provision of this Rule shall be deemed to prohibit the accountant from retaining such staff as may be considered appropriate, when the contracting of such staff is consistent with generally accepted audit standards;
- C. That the accountant understands the annual audited financial report and his or her opinion thereon will be filed in compliance with this Rule and that the Commissioner will be relying on this information in the monitoring and regulation of the financial position of insurer;
- D. That the accountant is aware of the requirements of Section 14 of this Rule and the accountant consents and agrees to make available for review by the Commissioner, or the commissioner's designee, the audit work papers as defined in Section 14;
- E. That the accountant holds a license issued by the respective authority of the state and is a member in good standing of the AICPA and an accredited member of the Puerto Rico Association of Certified Public Accountants; and
- F. That the accountant is in compliance with the requirements of Section 8 of the Rule.

SECTION 14. DEFINITION, AVAILABILITY, AND RETENTION OF THE WORK PAPERS OF THE INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

- A. Work papers are the records kept by the independent certified public accountant of the procedures followed, the tests performed, the information obtained, and the conclusions reached pertinent to the accountant's audit of the financial statements of an insurer. Work papers may include audit planning documentation, work programs, analyses, memorandum, letters of confirmation and representation, abstracts of the insurer's documents, and schedules, or comments 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. Insurers shall require the accountant to make available at the insurer's office, at the OCI office, or any other site reasonably designated by the Commissioner, for review by OCI examiners all work papers prepared during the audit and any communications related to the audit between the accountant and the insurer. Also, the insurer shall require that the independent certified public accountant retains all of the work papers and communications related to the audit until the OCI has issued an examination report covering the period of the audit but no longer than seven (7) years from the date of the audit report.
- C. It is agreed that during the aforementioned periodic review by the OCI examiners, all photocopies of the relevant work papers shall be retained by the OCI. The reviews by the OCI examiners shall be considered to be investigations and all work papers and communication obtained shall be treated with the same level of confidentiality as other inspection documents generated by the OCI.

SECTION 15. AUDIT COMMITTEE REQUIREMENTS

This Section shall not be applicable to foreign insurers authorized to transact insurance business in Puerto Rico or an insurer that is a SOX Compliant Entity or a direct or indirect wholly controlled subsidiary of a SOX Compliant Entity.

- A. 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 the preparation of the audit financial statements or any other work related to this Rule. Each accountant shall report directly to the audit committee.
- B. The audit committee of the insurer or group of insurers shall be responsible for overseeing the internal audit function of the insurer and for providing the person or personas who exercise that function with the appropriate authority and resources for performing their duties as provided in Section 16 of this Rule.
- C. Every 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 elected entity in accordance with Section 4E of this Rule.
- D. In order to be considered independent for the purposes of this section, a member of the Audit Committee may not, apart from his capacity as member of the Audit Committee, be part of the Board of Directors, or of any other board committee, accept any consulting, advisory, or other compensatory fee from the insurer. Also, a member of the Audit Committee may not be an affiliated person of the entity or any subsidiary thereof, or of the independent certified public accountant.

However, if by law board participation by non-independent member is required, that law shall prevail and such members may participate in the audit committee, unless they are officers or employees of the insurer or one of its affiliates.

- E. If a member of the audit committee ceases to be independent for reasons beyond the member's reasonable control, that person, with notice to the OCI, may remain an audit committee member of the entity until the earlier of the next annual meeting of the responsible entity or one (1) year from the occurrence of the event that caused the member to be no longer independent.
- F. To exercise the election of the controlling person to designate the audit committee for purposes of this Rule, the controlling person shall notify the commissioners of the affected insurers in writing. This notification shall be made in a timely manner, prior to the issuance of the audited report and include a description of the basis for the election. The election can be changed through notice to the Commissioner by the insurer, including a description of the basis for the change. The election shall remain in effect until rescinded.
- G.
 - (1) The audit committee shall require the independent certified public accountant to provide the Committee with a timely report of the following as required in SAS 61, *Communication with Audit Committees* or the document that replaces it:
 - (a) All significant accounting policies and material permitted practices;
 - (b) All alternative treatments of statutory accounting principles that have been discussed with management of the insurer, effects of the use of such principles and the required disclosure, 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 in G (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. 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 to \$500,000,000	Over \$500,000,000
No minimum requirements. See Notes A and B.	Majority (50% or more) of members shall be independent. See Notes A and B.	Super majority of members (75% or more) should be independents. See Note A.

Note A: 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 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.

Note B: 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.

Note C: 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. An insurer with direct written and assumed premium, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of less than five hundred million dollars (\$500,000,000) may make application to the Commissioner for a waiver from the Section 15 requirements based upon financial hardship. The insurer shall file, with its annual statement filing, the approval for relief of the requirements of Section 15 in the states that it is licensed in or doing business in and in the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

SECTION 16. INTERNAL AUDIT FUNCTION REQUIREMENTS

- A. Exemption - 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, for less than five hundred million dollars (\$500,000,000); and
 - (2) If the insurer is a member of a group of insurers, the group has annual direct written and unaffiliated assumed premium including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance

Corporation and Federal Flood Program, for less than one billion dollars (\$1,000,000,000).

- B. Function –The insurer or group of insurers shall establish an internal audit function providing independent, objective and reasonable assurance to the audit committee and insurer management regarding the insurer’s governance, risk management and internal controls. This assurance shall be provided by performing general and specific audits, reviews and tests and by employing other techniques deemed necessary to protect assets, evaluate control effectiveness and efficiency, and evaluate compliance with policies and regulations.
- C. Independence – In order to ensure that internal auditors remain objective, the internal audit function must be organizationally independent. Specifically, the internal audit function will not defer ultimate judgment on audit matters to others, and shall appoint an individual to head the internal audit function who will have direct and unrestricted access to the board of directors. Organizational independence does not preclude a dual-reporting relationship.
- D. Reporting – The head of the internal audit function shall report to the audit committee regularly, but no less than annually, on the periodic audit plan, factors that may adversely impact the internal audit function’s independence or effectiveness, material findings from completed audits, and the appropriateness of corrective actions implemented by management as a result of audit findings.
- E. Additional Requirements – 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.

SECTION 17. 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 false or misleading statement to an accountant in connection with any audit, review, or communication required under this Rule; or
 - (2) Omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which the statements were made, not misleading to an accountant in

connection with any audit, review, or communication required under this Rule.

- 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 intentionally influence an independent certified public accountant engaged in the performance of an audit 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 of this section, the actions described below include, but are not limited to actions taken during the period of the audit to coerce, manipulate, mislead, or intentionally influence an accountant:
 - (1) To issue or reissue a yearly report on an insurer's financial statements that is not warranted under the circumstances, due to material violations of statutory accounting principles prescribed by the OCI, generally accepted auditing standards, or other professional or regulatory standards;
 - (2) Not to perform audit, according to the procedures required by generally accepted auditing standards or other professional standards;
 - (3) Not to withdraw a filed report; or
 - (4) Not to communicate matters to the insurer's audit committee.

SECTION 18. 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 five hundred million dollars (\$500,000,000) or more shall prepare a report of the insurer's or group of insurers' internal control over financial reporting, as defined in Section 4 of this Rule. The report shall be filed with the OCI along with the Communication of Internal Control Related Matters Noted in an Audit described under Section 12 of this Rule. The Management's Report of Internal Control Over Financial Reporting shall be as of December 31 immediately preceding.
- B. Notwithstanding the premium threshold in Subsection A, the OCI may require an insurer to file Management's Report of Internal Control Over Financial Reporting if the insurer is in any RBC level event or meets any one or more of the standards of an insurer deemed to be in hazardous financial condition as defined in Chapter 45 of the Insurance Code.
- C. An insurer or group of insurers that is:
 - (1) directly subject to Section 404; or

- (2) part of a holding company system whose parent is directly subject to Section 404; or
- (3) not directly subject to Section 404 but is a SOX Compliant Entity; or
- (4) member of a holding company system whose parent is not directly subject to Section 404 but is a SOX Compliant Entity:

may file its own Section 404 Report or its parent's with an addendum in satisfaction of this Section 18 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 6B through 6G of this rule) were included in the scope of the Section 404 Report. The addendum shall include 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 (those items included in Section 6B through 6G of this rule) 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 (i) a Section 18 report, or (ii) the Section 404 Report and a Section 18 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. The 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 audited financial statements 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 the audited financial statements;
- (4) A statement that briefly describes the scope of work and whether any internal controls were excluded;
- (5) Disclosure of any unremedied material weaknesses. Management is not permitted to conclude that the internal control over audited financial

reporting is effective if there are one or more unremedied material weaknesses;

- (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/title).
- E. Management of the insurer shall document and make available for examination the basis upon which its assertions, required in the above 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.
- (1) Management of the insurer shall have discretion as to the nature of the internal control framework used, and the nature and extent of documentation, to support its assertion in a cost-effective manner. In addition, reference to existing documentation may be included.
 - (2) The OCI shall maintain the confidentiality of the Management's Report of Internal Control over Financial Reporting required in the above subsection A and any supporting documentation provided.

SECTION 19. EXEMPTIONS AND EFFECTIVE DATES

- A. Upon written application of any insurer, the OCI may grant an exemption from compliance with any and all provisions of this Rule if the Commissioner finds, upon review of the application, that compliance with this regulation would constitute a financial or organizational hardship upon the insurer. An exemption may be granted at any time and from time to time for a specified period or periods. Within ten (10) days from a denial of an insurer's written request for an exemption from this regulation, the insurer may request in writing a hearing on its application for an exemption. The hearing shall be held in accordance with Chapter 2 of the Insurance Code.
- B. Domestic and foreign insurers retaining an independent certified public accountant on the effective date of this Rule, shall comply with this regulation for the year ending December 31, 2022 and each year thereafter unless the Commissioner permits otherwise.
- C. Domestic insurers not retaining an independent certified public on the effective date of this Rule, may use the following dates for compliance, unless the OCI permits otherwise:
- (1) Filing with the OCI an audited financial statement as of December 31, 2022.

- (2) For the year ending December 31, 2022, and each subsequent year, such insurers shall file with the OCI all reports and communications as required in this Rule.
- D. Foreign insurers shall comply with this Rule for the year ending December 31, 2022, and every subsequent year, unless the OCI permits otherwise.
- E. The requirements of Section 8D continue to be in effect for the audit of the year ending on December 31, 2022 and subsequent years.
- F. The requirements of Section 15 will enter into effect on January 1, 2023. The insurer or group of insurers that are not required to have independent members in the audit committee or only a majority of independent members of the audit committee (not a supermajority), because total written and assumed premium is less than the threshold and subsequently becomes subject to any of the requirements due to changes in the premium, shall have one (1) year following the year the threshold is exceeded (but not earlier than January 1, 2023) 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 (1) calendar year following the date of acquisition or combination to comply with the independence requirements.
- G. The requirements of the Section 18, except as provided for Section 15 in the previous subsection, shall enter into effect for the reporting period ending on December 31, 2022 and every subsequent year. An insurer or group of insurers that is not required to file a report because total written premium is below the threshold and subsequently becomes subject to the reporting requirements shall have two (2) years following the year the threshold is exceeded (but not before December 31, 2022) to file the report. Likewise, an insurer acquired in a business combination shall have two (2) calendar years following the date of acquisition or combination to comply with the reporting requirements.
- H. The requirements of Section 16 will enter into effect on January 1, 2023. If the insurer or group of insurers exempted from the requirements of Section 16 no longer qualifies for the exemption, it shall have one year after the year the threshold is exceeded to comply with the requirements of this section.

SECTION 20. CANADIAN AND BRITISH INSURERS

- A. Canadian and British insurers. 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 7B shall state that the accountant is aware of the requirements relating to the annual audited financial report filed

with the Commissioner as provided in Section 5 and shall affirm that the opinion expressed is in conformity with those requirements.

SECTION 21. SEVERABILITY

If any word, sentence, paragraph, sub-paragraph, Section or part of this Rule were found to be null and void by a court of competent jurisdiction, the order of such court shall not affect or invalidate the remaining provisions of this Rule, and the effect of such order shall be limited to the word, sentence, paragraph, sub- paragraph, Section or part that has been found to be null and void.

SECTION 22. EFFECT

The provisions of this Rule shall enter into effect thirty (30) days after filing with the Department of State of Puerto Rico, under the provisions of the Public Law No. 170, *supra*.

SIGNED

ALEXANDER S. ADAMS-VEGA, ESQ.
COMMISSIONER OF INSURANCE

Date of Approval: May 10, 2022

Date of Filing with the Department of State:

Date of Filing with the Library of the Legislature: