

Economic Impact Statement
LSA Document #09-376

IC 4-22-2.1-5 Statement Concerning Rules Affecting Small Businesses

IC 4-22-2.1-5(a) provides that an agency that intends to adopt a rule under IC 4-22-2 that will impose requirements or costs on small businesses must prepare a statement that describes the annual economic impact of the rule on small businesses after the rule is fully implemented as described in IC 4-22-2.1-5(b). That statement must be submitted to the Indiana Economic Development Corporation (IEDC). The IEDC is required to review the rule and submit written comments to the agency not later than seven days before the public hearing.

The proposed rule will improve the department's surveillance of the financial condition of insurers by requiring an annual audit of financial statements reporting the financial position and the results of operations of insurers by independent certified public accountants, requiring the communication of internal control related matters noted in an audit, and requiring the management's report of internal control over financial reporting. The proposed rule is based upon a model regulation adopted by the National Association of Insurance Commissioners (NAIC). This model regulation must be effective in each state by December 31, 2009, in order for that state to maintain its accreditation with the NAIC. States failing to maintain NAIC accreditation will subject domestic insurers to financial examinations from each of the other 49 NAIC accredited states.

The rule will impact insurance companies doing business only in Indiana and writing more than \$1,000,000 in premium. Insurers doing business in other states are already required to comply with this rule in other states, so this proposed rule will not impact these multistate insurers. Certified public accountants will also be impacted by the proposed rule.

Estimated Number of Small Businesses Affected:

There is one insurance company that may meet the definition of small business as defined in IC 4-22-2.1-4 and that could be impacted by the proposed rule.

There are 9,457 certified public accountants (CPA) and 1,190 accounting firms in the state of Indiana. The number of CPAs and accounting firms meeting the definition of small business is unknown.

Estimated Administrative Costs Imposed on Small Businesses:

Under IC 27-1-3.5-6, domestic insurers are required to have an audit by an independent auditor and must file an audited financial report with the commissioner annually. The proposed rule would impose additional requirements on individuals and on entities not otherwise exempt from the rule and meeting the definition of small business. Insurers must designate a group of individuals to comprise an audit committee. CPAs must report directly to the audit committee. The audit committee must preapprove all auditing services and nonaudit services provided to the insurer by the CPA. Members of the audit committee may not accept compensatory fees, other than in his or her capacity as a member of the audit committee, from the entity or be an affiliated person of the entity or any subsidiary. The audit committee must require the CPA to timely report certain communications to the audit committee.

In addition to the annual audited financial report, insurers must furnish the commissioner with a written communication as to unremediated material weaknesses in its internal control over financial reporting noted during the audit, if any are noted. There will be a cost to CPAs in preparing the written communication. CPAs will presumably pass along any cost to the insurers. It is estimated that CPAs would charge insurers \$500 or less to prepare the written communication. The communication must be prepared by the CPA within 60 days after the filing of the annual audited financial report. The insurer must also provide a description of remedial actions taken or proposed to correct unremediated material weaknesses, if the actions are not described in the CPAs communication. It is estimated that this will cost insurers \$500 or less to prepare this description.

Officers and directors may not make false or misleading statements or omit to state material facts to CPAs in connection with audits, reviews, or communications. Officers and directors may not coerce, manipulate, mislead, or fraudulently influence CPAs conducting an audit.

Estimated Total Annual Economic Impact on Small Businesses:

The total annual economic impact on small businesses is \$1,000 or less. Insurers would only incur this cost if, during the course of the audit required by IC 27-1-3.5-6, the CPA notes unremediated material weaknesses in its internal control over financial reporting. If none are noted, insurers would not incur these costs.

Justification of Requirements or Costs:

The requirements and costs imposed on insurers and CPAs are minimal. If the proposed rule is not adopted and Indiana loses NAIC accreditation, each of the 49 other states could require Indiana domestic insurers to be examined. The costs of each financial examination would be borne by the domestic insurers and would be

financially burdensome.

Regulatory Flexibility Analysis:

The department determined that adoption of the model standards issued by the NAIC to maintain accreditation would be most beneficial to Indiana domestic insurers. There are no less intrusive or less costly alternative methods for achieving the purposes of the proposed rule.

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