

Audited Financial Statements for Managed Care Organizations

Effective date: 11/10/15

Summary of Express Terms

New Subpart 98-3 - Audited Financial Statements and Revision to 10 NYCRR 98-1.16(c)

The purpose of the amendments is to extend audit and reporting standards to all managed care organizations (MCOs) certified under Article 44 of the Public Health Law. The amendments will apply to MCOs (Prepaid Health Services Plans, HIV Special Needs Plans and Managed Long Term Care Plans) (PHSPs, HIV SNPs and MLTCPs) that were not included under the Department of Financial Services Regulation 118. This will ensure that all MCOs authorized to operate under Article 44 must adhere to the same financial reporting requirements and standards in the filing of audited financial statements.

The proposed regulation is closely patterned upon 11 NYCRR 89 (Regulation 118) adopted by the Department of Financial Services and the National Association of Insurance Commissioners model audit rule ("NAIC model") that reflects a consensus of the insurance regulators of all states and territories of the United States as to scope, detail, needs and benefits. The NAIC model imposes additional rules patterned on the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7201 et seq. ("SOX"), and is similar to Regulation 118 and the proposed amendments to Part 98.

The proposal adds provisions to Part 98 regarding the following:

- Designation of CPA.

- Qualifications of CPA.
- Consolidated or combined audits.
- Scope of audit and report of CPA.
- Notification of adverse financial condition.
- Communication of internal control related matters noted in an audit.
- CPA's letter of qualifications.
- Availability and maintenance of CPA work papers.
- Requirements for audit committees.
- Conduct of MCO in connection with the preparation of required reports and documents.
- Management's report of internal control over financial reporting.
- Effective date and special rules.

Pursuant to the authority vested in the Commissioner of Health by sections 4403(2) and 4403(f)(7) of the Public Health Law, a new Subpart 98-3 is added and Section 98-1.16(c) is amended of Title 10 (Health) of the Official Compilation of Codes, Rules and Regulations of the State of New York, to be effective upon publication of the Notice of Adoption in the New York State Register, to read as follows:

Subpart 98-3

Managed Care Organizations

Audited Financial Statements

(Statutory Authority: Public Health Law, Sections 4403 (2), 4403-F(7))

Section 98-3.1 Purpose.

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Section 98-3.15 Management's report of internal control over financial reporting.

Section 98-3.16 Effective date and special rules.

Section 98-3.1 Purpose.

The purpose of this Subpart is to apply audit and reporting standards upon managed care organizations (MCOs). These standards are modeled on the standards imposed on public companies by the Sarbanes-Oxley Act of 2002.

Section 98-3.2 Definitions.

For the purposes of this Subpart, the following definitions shall apply:

(a) *AICPA* means the American Institute of Certified Public Accountants.

(b) *Affiliate of*, or person *affiliated* with another person means a person that directly, or indirectly, controls, or is controlled by, or is under common control with, the other person specified.

(c) *Audit committee* means a committee (or equivalent body) established by the board of directors of a MCO for the purpose of overseeing the accounting and financial reporting processes of a MCO or group of MCOs, and audits of financial statements of the MCO or group of affected MCOs; provided that:

(1) For a holding company that controls a group of MCOs, the audit committee of the holding company may be deemed to be the audit committee for one or more of those controlled MCOs solely for the purposes of this Subpart even if all members of the holding company audit committee are not residents of this state;

(2) For a United States branch of an alien MCO, the audit committee may be comprised of the audit committee of the person that controls the United States branch; and

(3) For a MCO that does not otherwise designate an audit committee, the MCO's entire board of directors shall constitute the audit committee.

(d) *Audited financial report* means and includes those items specified in section 98-3.4 of this Subpart.

(e) *CPA* means:

(1) An independent certified public accountant or accounting firm, who or that meets requirements established by the PCAOB and is also a registrant in good standing with the AICPA and every state in which the accountant or the firm is licensed to practice; or

(2) For a United States branch of a Canadian or British insurer, "CPA" also includes a Canadian-chartered or British-chartered accountant.

(f) *Group of MCOs* means those MCOs that are:

(1) Part of a holding company system;

- (2) A MCO and its subsidiaries that are not part of a holding company system; or
- (3) A subset of a group of MCOs described in either paragraph (1) or (2) of this subdivision, which the MCO identifies for aggregation to implement and assess internal control over financial reporting.

(g) *Indemnification* means an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the CPA for failure to adhere to applicable auditing or professional standards, whether or not resulting in part from knowing of other misrepresentations made by the MCO or its representatives.

(h) *Independent audit committee member* has the meaning described in section 98.13(c) of this Subpart.

(i) *Internal control over financial reporting* means a process effected by a MCO's board of directors, management and other personnel designed to provide reasonable assurance regarding the reliability of those items specified in section 98-3.4 of this Subpart and includes those policies and procedures that:

- (1) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets;
- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements, and that receipts and expenditures are

being made only in accordance with authorizations of management and directors;
and

(3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements.

(j) For purposes of this Subpart, *MCO means* a Prepaid Health Services Plans, HIV Special Needs Plans and Managed Long Term Care Plans (PHSP, HIV SNP and MLTCP).

(k) *NAIC* means the National Association of Insurance Commissioners.

(l) *PCAOB* means the Public Company Accounting Oversight Board, which was established by the Sarbanes-Oxley Act of 2002, 15 U. S. C. § 7201 et seq.

(m) *Prior calendar year direct written and assumed premiums* means the MCO's combined total of direct premiums and assumed premiums from non-affiliates.

(n) *SEC* means the United States Securities and Exchange Commission.

(o) *SOX* means the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7201 et seq.

(p) *SOX compliant MCO* means a MCO that either is required to be compliant with, or voluntarily is compliant with, all of the following provisions of the Sarbanes-Oxley Act of 2002:

- (1) The preapproval requirements of section 201 (section 10A(i) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1(i));
- (2) The audit committee independence requirements of section 301 (section 10A(m)(3) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1(m)(3)); and
- (3) The internal control over financial reporting requirements of section 404 (Item 308 of SEC Regulation S-K).

(q) *SOX section 404* means section 404 of the Sarbanes-Oxley Act of 2002 titled “management assessment of internal controls” and any rules and regulations promulgated thereunder.

(r) *SOX section 404 report* means “management’s report on internal control over financial reporting” as defined by SOX section 404 and any rules or regulations promulgated thereunder.

(s) *Work papers* mean the records kept by the CPA of the procedures followed, the tests performed, the information obtained, the conclusions reached pertinent to the CPA’s audit of the financial statements of a MCO, and any communication between the CPA and the MCO relating to the CPA’s audit of the MCO. Work papers include audit planning documentation, work programs, analyses, memoranda, letters of confirmation

and representation, abstracts of MCO documents and schedules or commentaries prepared or obtained by the CPA in the course of the CPA's audit of the financial statements of a MCO and that support the CPA's opinion.

Section 98-3.3 General requirements related to filing of annual audited financial reports and audit committee appointment.

(a) Every MCO shall file an audited financial report with the Commissioner on or before April 1 for the year ended December 31 immediately preceding.

(b) Every MCO required to file an annual audited financial report pursuant to this Subpart shall designate a group of individuals to constitute its audit committee.

Section 98-3.4 Contents of annual audited financial report.

(a) The annual audited financial report shall report the financial position of the MCO as of the end of the most recent calendar year and the results of its operations, cash flows and changes in capital and surplus for the year then ended in conformity with statutory accounting practices prescribed, or otherwise permitted, by the New York State Department of Financial Services pursuant to 11 NYCRR 83. In addition, a company may comply by filing statements prepared in accordance with generally accepted accounting principles, provided that appropriate reconciliation is made as required by

Section 307 of Insurance Law. The annual audited financial report shall include the following:

- (1) Report of CPA.
- (2) Balance sheet reporting admitted assets, liabilities, capital and surplus.
- (3) Statement of operations.
- (4) Statement of cash flow.
- (5) Statement of changes in capital and surplus.

(b) Notes to financial statements shall be those required by the appropriate *Annual Statement Instructions* and those accounting practices and procedures to be followed as specified in Part 83 of 11 NYCRR and shall include a reconciliation of differences, if any, between the audited statutory financial statements and the annual statement filed pursuant to Section 98-1.16 of this Part with a written description of the nature of these differences.

(c) The MCO shall prepare the financial statements included in the audited financial report in a form and using language and groupings substantially the same as the relevant sections of the annual statement of the MCO filed with the Commissioner, and the financial statement shall be comparative, presenting the amounts as of December 31 of the current year and the amounts as of the immediately preceding December 31. In the first year in which a MCO is required to file an audited financial report, the comparative data may be omitted.

Section 98-3.5 Designation of CPA.

(a) Every MCO that files an annual audited financial report shall inform the Commissioner in writing of the name and address of the CPA retained to conduct the annual audit set forth in this Subpart. The MCO shall provide the name, address, telephone number and email address of its CPA to the Commissioner by March 1, 2015, and except as otherwise provided in this section, provide updated information within 60 days of any change in CPA thereafter.

(b) The MCO shall obtain a letter from the CPA, and file a copy with the Commissioner, stating that the CPA is aware of the provisions of the insurance law and the regulations thereunder of the state of domicile that relate to accounting and financial matters and affirming that the CPA will express his or her opinion on the financial statements in terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by the Department of Financial Services, specifying such exceptions as the CPA may believe appropriate.

(c) If the CPA is dismissed or resigns:

(1) The MCO shall notify the Commissioner within five business days of the event.

(2) The MCO shall submit a letter to the Commissioner within 15 business days of the event stating whether there were any disagreements at the decision-making level with the former CPA within the previous two years (whether or not resolved to the CPA's satisfaction) on any matter of accounting principles or practices, financial

statement disclosure, or auditing scope or procedure that might or could have been referenced in the CPA's opinion attached to the audited financial report and detailing with specificity the nature and extent of any such disagreements.

(3) The MCO shall submit, with the letter required by paragraph (2) of this subdivision, a letter from the former CPA to the Commissioner stating whether the CPA agrees with the statements contained in the MCO's letter and, if not, stating the reasons for which the CPA does not agree.

Section 98-3.6 Qualifications of CPA.

(a) A MCO may utilize a CPA for the purposes specified in this Subpart provided that the CPA:

- (1) Meets the definition of a CPA set forth in section 98-3.2(e) of this Subpart;
- (2) Has not either directly or indirectly entered into an agreement of indemnity or release from liability (collectively referred to as *indemnification*) with respect to the audit of the MCO;
- (3) Acts in conformity with the standards of the accounting profession, such as set forth in the Code of Professional Ethics of the AICPA and Rules and Regulations and Code of Ethics of Professional Conduct of the New York Board of Public Accountancy, or similar code; and
- (4) Utilizes its staff consistent with the standard prescribed by generally accepted auditing standards.

(b) A MCO may enter into an agreement with a CPA to have disputes relating to an audit resolved by mediation or arbitration. However, in the event of a proceeding commenced under Insurance Law Article 74 against the MCO, the mediation or arbitration provisions shall apply only with the permission of the statutory successor.

(c)(1) A MCO shall not utilize the same lead or coordinating CPA as an audit partner who has primary responsibility for the audit for more than five consecutive years. The person shall be disqualified from acting in that or a similar capacity for the same MCO or its insurance subsidiaries or affiliates for a period of five consecutive years.

(2) A MCO may make application to the Commissioner for relief from the rotation requirement contained in paragraph (1) of this subdivision on the basis of unusual circumstances. The application shall be made at least 30 days before the end of the calendar year and include the following details:

- (i) Number of partners, expertise of the partners or the number of insurance clients in the currently registered firm;
- (ii) Premium volume of the MCO; and
- (iii) Number of jurisdictions in which the MCO transacts business.

(3) If relief is granted from the requirements of this subdivision, the MCO shall file a copy of each grant of relief received by the MCO with each state in which it is licensed or doing business and with the NAIC.

(d) A MCO may not utilize for any purpose of this Subpart any work performed or prepared by a CPA 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 demonstrated a pattern or practice of failing to detect or disclose material information in previous reports filed under the provisions of this Subpart.

(e)(1) A MCO may not utilize for any purpose of this Subpart any work performed or prepared by a CPA if that CPA also contemporaneously provides any of the following non-audit services:

- (i) Bookkeeping or other services related to the accounting records or financial statements of the MCO;
- (ii) Financial information systems design and implementation;
- (iii) Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- (iv) Actuarial advisory services involving the determination of amounts recorded in the financial statements. However, the CPA may assist a MCO in understanding the methods, assumptions and inputs used to determine amounts recorded in the financial statement, but only if it is reasonable to conclude that those amounts will not be subject to question during an audit of the MCO's financial statements. A CPA's actuary may also issue an actuarial opinion or

certification (“opinion”) on a MCO’s reserves if the following conditions have been met:

- (a) Neither the CPA nor the CPA’s actuary has performed any management functions or made any management decisions;
- (b) The MCO has competent personnel (or engages a third party actuary) to estimate the reserves for which management takes responsibility; and
- (c) The CPA’s actuary tests the reasonableness of the reserves after the MCO’s management has determined the amount of the reserves;

(v) Internal audit outsourcing services;

(vi) Management functions or human resources;

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

(viii) Legal services or expert services unrelated to the audit.

(2) The MCO shall attach a statement to its audited annual financial statement, when filed, that the CPA does not function in the role of management, does not audit his or her own work, and does not serve in an advocacy role for the MCO.

(f) A MCO may permit a CPA who performs the audit to engage in non-audit services, including tax and other services, which are not prohibited by subdivision (e)(1) of this section, but only if the activity is approved in advance by the audit committee, in accordance with subdivision (h) of this section.

(g) A MCO having direct written and assumed premiums of less than \$100,000,000 in any calendar year may request an exemption from subdivision (e)(1) of this section. The

MCO shall file with the Commissioner a written statement discussing the reasons why the MCO should be exempt from these provisions. The Commissioner may grant the exemption upon a finding that compliance would constitute a financial or organizational hardship upon the MCO.

(h) The MCO's audit committee shall preapprove all auditing services and non-audit services provided to the MCO by a CPA of the MCO except that a MCO need not preapprove non-audit services if:

(1) The MCO is a SOX compliant MCO or a direct or indirect wholly-owned subsidiary of a SOX compliant MCO; or

(2)(i) The aggregate amount of all such non-audit services provided to the MCO constitute five percent or less of the total amount of fees paid by the MCO to its CPA during the fiscal year in which the non-audit services are provided;

(ii) The services were not recognized by the MCO at the time of the engagement to be non-audit services; and

(iii) 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.

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

section. 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.

(j)(1) A MCO shall not utilize a CPA if a member of the board, president, chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for that MCO, was employed by the CPA and participated in the audit of that MCO during the one-year period preceding the date that the most current statutory opinion is due. This section shall only apply to partners and senior managers involved in the audit. A MCO may make application to the Commissioner for relief from the above requirement on the basis of unusual circumstances.

Section 98-3.7 Consolidated or combined audits.

A MCO may make written application to the Commissioner for approval to file audited consolidated or combined financial statements in lieu of separate annual audited financial statements, if the MCO is part of a group of MCOs that utilizes a pooling or 100 percent reinsurance agreement that affects the solvency and integrity of the MCO's reserves and the MCO cedes all of its direct and assumed business to the pool. In such cases, a columnar consolidating or combining worksheet shall be filed with the report, as follows:

(a) Amounts shown on the consolidated or combined audited financial report shall be shown on the worksheet;

- (b) Amounts for each MCO subject to this section shall be stated separately;
- (c) Noninsurance operations must 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 MCO columns of the worksheet and comparable amounts shown on the annual statements of the MCOs.

Section 98-3.8 Scope of audit and report of CPA.

A MCO shall have financial statements furnished pursuant to section 98-3.4 of this Subpart audited by the CPA. The audit of the MCO's financial statements shall be conducted in accordance with generally accepted auditing standards. The MCO shall attach to its financial statements a description, for each person assigned to the engagement pursuant to section 98-3.11 of this Subpart, of the following: the accountant's background and experience in general, the accountant's experience with insurance matters, and whether each is a CPA.

Section 98-3.9 Notification of adverse financial condition.

(a) Every MCO required to furnish an annual audited financial report shall require the CPA to report, in writing, to the Commissioner, the board of directors and the MCO's audit committee within five business days of any determination by the CPA that the MCO has materially misstated its financial condition as reported to the Commissioner as of the balance sheet date currently under audit or that the MCO does not meet the contingent reserve requirement of 10 NYCRR 98-1.11(e).

(b) A MCO shall ensure that, if the CPA, subsequent to the date of the audited financial report filed pursuant to this regulation, becomes aware of facts that might have affected the report, the CPA acts in accordance with professional obligations imposed by the AICPA and PCAOB.

Section 98-3.10 Communication of internal control related matters noted in an audit.

(a) In addition to the annual audited financial report, every MCO shall obtain from its CPA a written communication stating whether or not the CPA has noted any unremediated material weaknesses in the MCO's internal control over financial reporting during the audit. The communication prepared by the CPA shall also contain a description of any unremediated material weakness as of December 31 of the immediately preceding year.

(b) The MCO shall provide a description of remedial actions taken or proposed to correct unremediated material weaknesses, if the actions are not described in the CPA's communication.

(c) The MCO shall submit the written communication to the Commissioner as part of the filing of each annual audited financial report filed with the Commissioner, as required by 10 NYCRR 98-1.16(c).

Section 98-3.11 CPA's letter of qualifications.

Every MCO subject to this Subpart shall retain a CPA who agrees by written contract with such MCO to comply with the provisions of this section and 98-1.16. The contract must specify:

(a) That the CPA is independent with respect to the MCO and is acting in conformity with the standards of the CPA's profession, such as contained in the Code of Professional Ethics and pronouncements of the AICPA and the Rules of Professional Conduct of the New York Board of Public Accountancy, or similar code and meets the definition of a CPA set forth in subdivision (e) of section 98-3.2 of this Subpart;

(b) That the CPA understands the annual audited financial report, that the CPA's opinion thereon will be filed in compliance with this Subpart and that the Commissioner will be

relying on this information in the monitoring and regulation of the financial condition of the MCO;

(c) That the CPA consents to the requirements of section 98-3.12 of this Subpart and that the CPA consents and agrees to make available the work papers for review by the Commissioner; and

(d) A representation that the CPA is in compliance with the requirements of section 98-3.6 of this Subpart.

Section 98-3.12 Availability and maintenance of CPA work papers.

Every MCO shall require the CPA to make available for review by the Commissioner all work papers prepared in the conduct of the CPA's audit and any communications related to the audit between the CPA and the MCO, at the offices of the MCO, at the Health Department or at any other reasonable place designated by the Commissioner. Every MCO shall require that the CPA retain the audit work papers and communications for six calendar years from the date of the audit report.

Section 98-3.13 Requirements for audit committees.

(a) The audit committee shall be directly responsible for the appointment, compensation and oversight of the work of any CPA (including resolution of disagreements between

management and the CPA regarding financial reporting) for the purpose of preparing or issuing the audited financial report or related work pursuant to this Subpart. Every CPA shall report directly to the audit committee.

(b) Every member of the audit committee shall be a member of the board of directors, a member of the board of directors of a member of the holding MCO system or, for a United States branch of an alien MCO, a member of the audit committee of the person that controls the branch.

(c) In order to be considered independent for purposes of this section, a member of the audit committee may not, other than in the member's capacity as a member of the audit committee, the board of directors, or any other board committee, accept any consulting, advisory or other compensatory fee from the MCO or be an affiliated person of the MCO or any subsidiary thereof, except to the extent that any law may require board participation by otherwise non-independent members, and, in such case, the member may participate in the audit committee and be designated as independent for audit committee purposes, unless the member is an officer or employee of the MCO or one of its affiliates.

(d) If a member of the audit committee ceases to be independent for reasons outside the member's reasonable control, that person may remain an audit committee member of the responsible MCO until the earlier of the next annual meeting of the responsible MCO or one year from the occurrence of the event that caused the member to be no longer independent, provided that the MCO promptly notifies the Commissioner.

(e) The MCO shall give written notice to the Commissioner of the selection of its audit committee within 30 days of the effective date of this Subpart and within 30 days of any change in membership of the audit committee. The notice shall include a description of the reason for the change.

(f)(1) The audit committee shall require the CPA that performs any audit for a MCO that is required by this Subpart to timely report to the audit committee:

- (i) All significant accounting policies and material permitted practices;
- (ii) All material alternative treatments of financial information within statutory accounting principles that have been discussed with management officials of the MCO, ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the CPA; and
- (iii) Other material written communications between the CPA and the management of the MCO, such as any management letter or schedule of unadjusted differences.

(2) If a MCO is a member of a group of MCOs, the reports required by paragraph (1) of this subdivision may be provided to the audit committee on an aggregate basis for the group, provided that any substantial differences among MCOs in the system are identified to the audit committee.

(g) The proportion of independent audit committee members for a MCO shall meet or exceed the following minimum criteria:

- (1) If the MCO's prior calendar year direct written and assumed premiums are equal to or less than \$300,000,000, no members of the audit committee shall be required to be independent;
- (2) If the MCO's prior calendar year direct written and assumed premiums are greater than \$300,000,000 but not more than \$500,000,000, 50% or more of the members of the audit committee shall be independent, unless otherwise provided by law as for a MCO; or
- (3) If the MCO's prior calendar year direct written and assumed premiums are more than \$500,000,000, 75% or more of the members of the audit committee shall be independent.

(h) This section shall not apply to:

- (1) A MCO that is a SOX compliant MCO or a directly or indirectly wholly-owned subsidiary of a SOX compliant MCO.

Section 98-3.14 Conduct of MCO in connection with the preparation of required reports and documents.

(a) Any director or officer of a MCO, or any other person acting under the direction thereof, shall not, directly or indirectly:

- (1) Make or cause to be made a materially false or misleading statement to a CPA in connection with any audit, review or communication required under this Subpart; 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 a CPA in connection with any audit, review or communication required under this Subpart.

(b) Any officer or director of a MCO, or any other person acting under the direction thereof, shall not directly or indirectly take any action to coerce, manipulate, mislead or fraudulently influence any CPA engaged in the performance of an audit pursuant to this Subpart if that person knew or should have known that the action, if successful, could result in rendering the MCO's financial statements materially misleading, including any action taken at any time with respect to the professional engagement period to coerce, manipulate, mislead or fraudulently influence a CPA:

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

Section 98-3.15 Management's report of internal control over financial reporting.

(a) Every MCO required to file an audited financial report pursuant to this Subpart that has annual direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of \$500,000,000 or more shall prepare a report of the MCO's or group of MCOs' internal control over financial reporting. This report of internal control over financial reporting, together with any communication about unremediated material weaknesses discovered during the CPA's audit described under section 98-3.10 of this Subpart shall be submitted to the Commissioner upon the filing date upon which each audited financial report is required to be filed. Management's report of internal control over financial reporting shall be as of December 31 immediately preceding.

(b)(1) In lieu of the report required by subdivision (a) of this section, a MCO may file its or its parent's SOX section 404 report with the Commissioner, if the MCO is:

- (i) Directly subject to SOX section 404;
- (ii) Not directly subject to SOX section 404, but is a SOX compliant MCO; or
- (iii) A member of a holding MCO system whose parent is:
 - (a) Directly subject to SOX section 404; or
 - (b) Not directly subject to SOX section 404, but is a SOX compliant MCO.

(2) If a MCO elects to file the SOX section 404 report described in paragraph (1) of this subdivision, the MCO shall submit an addendum that contains:

- (i) A statement by the MCO's chief executive officer and chief financial officer (or equivalent position or title) that no internal controls having a material impact on the preparation of the MCO's audited statutory financial statements are excluded from the report. If either of these two officers is based in a holding MCO or other entity outside of the United States, the two most senior United States-based officers shall be the signatories; or
- (ii) If internal controls of the MCO that have a material impact on the preparation of the MCO's audited statutory financial statements are not described in the SOX section 404 report, a report that sets forth the impact of these material internal controls on the preparation of the MCO's audited financial reports that were not included in the report.

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

- (1) A statement that the MCO has established and continues to maintain adequate internal control over financial reporting and an assertion, to the best of the MCO'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;
- (2) A statement that briefly describes the approach or processes by which the MCO evaluated the effectiveness of its internal control over financial reporting;
- (3) A statement that briefly describes the scope of work that is included and whether any internal controls were excluded;

(4) Disclosure of any unremediated material weaknesses in the internal control over financial reporting identified by the MCO as of December 31 immediately preceding.

(5) A statement regarding the inherent limitations of internal control systems; and

(6) Notarized signatures of the MCO's chief executive officer and chief financial officer (or equivalent position or title) attesting to the statements and disclosures contained in paragraphs (1) through (5) of this subdivision. If either of these two officers is based in a holding MCO or other entity outside of the United States, the two most senior United States-based officers shall be the signatories.

(d) The MCO shall document the basis upon which the assertions, as required by subdivision (c) of this section, are made. The MCO may base its assertions, in part, upon its review, monitoring and testing of internal controls undertaken in the normal course of its activities. The MCO 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.

Section 98-3.16 Effective date and special rules.

(a) Effective date.

(1) The requirements of this Subpart, subject to subdivision (b) of this section, shall apply beginning with the reporting period ending December 31, 2015.

(2) A MCO acquired in a business combination shall have two calendar years following the date of acquisition or combination to comply with this Subpart.

(b) Special rules.

(1) Changes in required number of independent audit committee members.

(i) A MCO that is required to have a higher number of independent audit committee members due to changes in premium shall have one year following the year the threshold is exceeded to comply with the independence requirements; and

(ii) A MCO that becomes subject to a different independence requirement as a result of a business combination shall have one calendar year following the date of acquisition or combination to comply with the newly effective independence requirements.

(2) Upon written application by any MCO, the Commissioner may, if not inconsistent with any statutory requirement to the contrary, extend a filing date or grant an exemption from compliance with any and all provisions of this Subpart if the Commissioner finds, upon review of the application, that compliance with this Subpart would constitute a financial or organizational hardship upon the MCO. A MCO shall file an application for a hardship exemption with the Commissioner prior to the event or period for which the extension or exemption is being requested. The MCO shall file, with its annual statement filing, both its request for relief and the approval of that request with the states that it is licensed in or doing business in

and the NAIC. If a nondomestic state accepts electronic filing with the NAIC, the MCO shall file the approval in an electronic format acceptable to the NAIC.

§98-1.16(c) shall be amended as follows:

(c) every MCO shall submit annual financial statements together with an opinion of an independent certified public accountant of the financial statement of such MCO, and an evaluation by such accountant of the accounting procedures and internal control systems of the MCO, by April 1 of each year, pursuant to Subpart 98-3.

Regulatory Impact Statement

Statutory Authority:

Sections 4403(2), 4403-f(7) of the Public Health Law. These sections establish the Commissioner's authority to promulgate regulations governing the operations of managed care organizations (MCOs), including the preparation and filing of audited financial statements.

Public Health Law section 4403(2) states the Commissioner may adopt and amend rules and regulations pursuant to the state administrative procedures act to effectuate the purposes and provisions of Article 44.

Public Health Law section 4403-f(7) states the Commissioner shall promulgate regulations to implement this section and to ensure the quality , appropriateness and cost-effectiveness of the services provided by managed long term care plans.

Legislative Objectives:

10 NYCRR 98 was extensively amended in 2005 to further implement the provisions of Article 44 of the Public Health Law. The proposed amendment to section 98-1.16(c) and the promulgation of the new section 98-3 adds new provisions consistent with the provisions of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7201 et seq. ("SOX") and 11 NYCRR 89.

Needs and Benefits:

SOX imposes a comprehensive regime of audits and internal management controls and reports designed to ensure greater transparency and accountability.

The proposed regulation is closely patterned upon 11 NYCRR 89 (Regulation 118) adopted by the Department of Financial Services (DFS), formerly the NYS

Department of Insurance, and the National Association of Insurance Commissioners model regulation ("NAIC model") that reflects a consensus of the insurance regulators of all states and territories of the United States as to scope, detail, needs and benefits. The NAIC model imposes additional rules patterned on SOX and is similar to Regulation 118 and the proposed amendments to Part 98. For example, the NAIC model, Regulation 118 and the proposed amendments to Part 98 all require the regulated insurer to forbid its certified independent public accountant (CPA) from entering into an agreement of indemnity or release from liability.

The proposed amendments will apply to managed care organizations (MCOs), such as PHSPs, HIV SNPs and MLTCPs, that were not included under Regulation 118. This will ensure that all MCOs authorized to operate under Article 44 must adhere to the same financial reporting requirements and standards.

The proposed amendments, once adopted, will ensure that regulated companies engage in best practices related to auditor independence, corporate governance and internal controls over financial reporting.

Costs:

This regulation imposes no compliance costs on state or local governments. There will be no additional costs incurred by the Health Department. Costs to be incurred by the parties affected differ depending upon the size of the company and whether that company is publicly held and thus already required to comply with SOX. Companies regulated by SOX will incur few additional costs. Compliance cost estimates received by DFS from a cross-section of affected companies that are not subject to SOX are most

often estimated to be minimal or negligible. Of those companies that stated compliance would require additional expenditures, the cost is estimated to be about \$25,000.

Local Government Mandates:

The regulation imposes no new programs, services, duties or responsibilities on any county, city, town, village, school district, fire district or other special district.

Paperwork:

Paperwork associated with filings to the commissioner should be minimal. The paperwork associated with the audit and controls regime required by the proposed regulation should also be minimal.

Duplication:

The proposal does not duplicate any existing federal, state, or local regulations.

Alternatives:

In developing Regulation 118, the DFS obtained industry input and hued to the model regulation developed by the National Association of Insurance Commissioners (the "NAIC model") to implement SOX to the extent possible. However, the model has been modified as necessary to comply with New York statutes and regulations. The proposed regulation also restricts its application only to those entities over which the Health Department has jurisdiction unlike the NAIC model, which also contains rules that apply to CPAs.

Several comments received by DFS noted the compliance difficulties faced by foreign companies and United States branches of alien insurers, specifically with respect to the roles to be performed by persons not residing in the United States and for the reporting requirements to be imposed upon an integrated enterprise containing insurers in

New York as well as entities with no nexus to New York. In response, the DFS modified Regulation 118, as reflected in the proposed amendments to part 98, to provide detailed rules as to whether members of management may attest to filings, and to establish limited exceptions available only to these entities, in addition to the provision that permits a waiver of any provision of the regulation upon evidence of financial or organizational hardship.

Another commenter objected to restrictions on using the same CPA for SOX audit work and tax return preparation for more than a five-year period for small companies. The exemption from any provision of the proposed regulation available upon proof of financial or organization hardship now addresses this comment.

Several comments noted that a company may be required to file both SOX reports and the reports required by the NAIC model as adopted by the various states. Companies want to avoid making duplicative filings to those required by the state of domicile. The proposed regulation contemplates accepting the domiciliary state filings as New York filings to the extent that they are substantially similar to those required by the proposed regulation.

Several comments noted differences between the NAIC model and the proposed regulation on filing deadlines, exceptions and the rules governing confidentiality of work papers. Different dates or deadlines are due to restrictions in New York law that require modification to the NAIC model. Certain automatic exclusions from the NAIC model could not be included in the proposed regulation to the extent that they conflict with New York law. Finally, the confidentiality of commercial information, including work papers, obtained by state and local government is already subject in New York to a

comprehensive regime of rules, exceptions and requirements, and thus did not need to be addressed in the proposed regulation.

Federal Standards:

The federal rules under SOX are extensive. The provisions in the proposed regulation are similar to the comparable federal provisions. The regulation does not conflict with any federal rules.

Compliance Schedule:

The regulation would apply beginning with the reporting period ending December 31, 2015. The initial audited financial statements completed under this regulation would be the 2015 annual statements due April 1, 2016.

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Regulatory Flexibility Analysis for Small Businesses and Local Governments

The Health Department finds that this regulation would not impose reporting, recordkeeping or other requirements on small businesses since the provisions contained therein apply only to regulated MCOs authorized to do business in New York State. Inasmuch as most of these companies are not independently owned and operated and employ more than 100 individuals, they do not fall within the definition of "small business" as found in section 102(8) of the State Administrative Procedure Act. MCOs that qualify as a small business will need to document that the processes and rules established by the regulation have been followed, consistent with current recordkeeping requirements. The Health Department has determined that such recordkeeping will be routine and will not have an adverse economic impact on the MCO.

Compliance costs estimates reported by the Department of Financial Services varies from \$25,000 a year to in excess of \$2 million (for one large mutual insurance company that is not a MCO covered by Part 98). However, the proposed amendments allow any company, including a small business, to request an exemption from any and all of its requirements upon written application to the commissioner based upon a financial or organizational hardship upon the company.

These amendments contain minimum requirements that must be included in the contract between a regulated company and the CPA retained by the company. Accordingly, CPAs, regardless of whether they are small businesses or not, could be considered affected parties under this regulation. However, the Health Department estimates the impact of the continuation of these rules to be minimal, especially since if a

CPA agrees to audit a regulated company, the price of the engagement will compensate the CPA for costs incurred. Additionally, CPAs retained by insurers tend to be large limited liability corporations or partnerships that are not small businesses. In any event, a CPA may choose not to audit a company that will require execution of a contract subject to these amendments.

There are no technological impediments to compliance with the proposed rule. Comments about the proposed rule were requested from the MCOs and MCO plan associations, and all responses were reviewed. One commentator indicated that compliance with the regulation could be a financial hardship for some small MCOs. However, as noted above, MCOs may request an exemption from any and all of its requirements upon written application to the commissioner based upon a financial or organizational hardship upon the company.

The amendments do not impose any impact, including any adverse impact, or reporting, recordkeeping, or other compliance requirement on any local government.

Rural Area Flexibility Analysis

Types and Estimated Number of Rural Areas:

Companies affected by the proposed regulation include PHSPs, HIV SNPs and MLTCPs authorized to do business in New York State. The companies affected by this regulation do business in certain "rural areas" as defined under section 102(1) of the State Administrative Procedure Act. Some of the home offices of these companies may lie within rural areas. Further, companies may establish new office facilities and/or relocate in the future depending on their requirements and needs.

Reporting, Recordkeeping and Other Compliance Requirements:

Many of the compliance requirements (such as filing due date and record retention period) are consistent with the requirements presently contained in Part 98 and should not impose upon any regulated party, regardless of whether they are located in a rural area or not, any additional paperwork, recordkeeping or compliance requirements. The obligations imposed by the proposed regulation with regard to establishment and maintenance of audit controls and standards are consistent with those required by current Part 98 and a federal statute, the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7201 et seq. ("SOX"), that imposes similar rules. If there are failures in the audit and controls process, a company is required to notify the Commissioner. The regulation contains automatic exclusions from compliance for certain small companies. Further, any company that faces organizational or financial hardship can seek an exemption from any requirement imposed by the regulation.

The proposed regulation requires a regulated company to perform the audit of its operation and controls with the assistance of CPA. The terms of the employment of the

CPA and the period for which work papers and communications are to be retained are both specified in the proposed regulation. Accordingly, CPAs, regardless of whether they are located in rural areas or not, could be considered affected parties under this regulation. However, the Health Department estimates the impact of these rules on CPAs, regardless of whether they are located in rural areas or not, should be negligible, if any at all. Indeed, if a CPA agrees to audit a regulated company, the price of the engagement will compensate the CPA for costs incurred. Additionally, CPAs retained by insurers tend to be large limited liability corporations or partnerships that are not small businesses. In any event, a CPA may choose not to audit a company that will require execution of a contract subject to this regulation.

Costs:

The proposed regulation implements requirements largely based on the rules imposed by SOX. The cost of complying with the new requirements will depend on the size of the company and whether the company is already subject to SOX because it is publicly held. Companies regulated by SOX will incur few additional costs beyond those imposed by current Regulation 118 and the federal statute. Compliance cost estimates with respect to the proposed regulation were received from a cross-section of companies that are not subject to SOX. If the company is already required to comply with similar regulations in other states, the additional expense of the New York proposed regulation is estimated to be minimal or negligible. Of those companies that stated compliance would require additional expenditures, the cost is estimated to be about \$25,000. However, the proposed regulation requires a regulated company to perform the audit of its operation and controls with the assistance of a CPA. The terms of the employment of a CPA is

specified in the proposed regulation. Further, a CPA can obtain compensation for additional costs as part of the contract entered into with the regulated company.

Accordingly, CPAs, regardless of whether they are located in rural areas or not, should not have to incur uncompensated additional costs to comply with the proposed regulation.

Minimizing Adverse Impact:

The proposed regulation applies PHSPs, HIV SNPs and MLTCPs authorized to do business throughout New York State, including rural areas. It does not impose any adverse impacts unique to rural areas.

Rural Area Participation:

In developing Regulation 118, the DFS conducted extensive outreach to regulated insurers, fraternal benefit societies and managed care organizations authorized to do business throughout New York State, including those located or domiciled in rural areas. Comments were also requested by the Department of Health from all PHSPs, HIV SNPs and MLTCPs affected by this regulation.

Job Impact Statement

The Health Department finds that these amendments will have no adverse impact on jobs and employment opportunities since, for publicly held companies, its requirements largely reflect obligations already imposed by the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7201 et seq. For MCOs, compliance may require the employment of additional personnel or outside contractors.

No region in New York should experience an adverse impact on jobs and employment opportunities. This regulation should not have a negative impact on self-employment opportunities.

Assessment of Public Comment

The public comment period for this regulation ended on December 8, 2014. The Department received 4 comments.

One comment was submitted by Hinman Straub, P.C. on behalf of a prepaid health services plan (PHSP) in Western New York that offers Medicaid Managed Care (MMC), Family Health Plus (FHP) and CHP programs. The comment was a request to revise the regulation to allow PHSPs to file financial reports using either statutory accounting principles (SAP) or generally accepted accounting principles (GAAP).

The Model Audit Rule that was submitted for comment provided for PHSPs, MLTCs and HIV SNPs submitting their audited financial statements on a SAP basis. The proposed rule would clarify that PHSPs, MLTCs, and HIV SNPs may submit the audited financial statement in accordance with GAAP, as long as a reconciliation to SAP is also included, in order to align the Model Audit Rule with DFS Regulation 118.

Another comment was from the Health Plan Association (HPA), and it stated that PHSPs, HIV SNPs and MLTCs would need an additional year to come into compliance with the Proposed Regulation. In addition, the comment indicated that the Proposed Regulation did not apply the same standards to financial reports as DFS Regulation 118, therefore the financial reports HMOs file with DFS might not comply with this proposed regulation. The comment requested that Section 98-3.4 of the Proposed Regulation be revised to allow MCOs to file audited financial statements in accordance with GAAP, in conformance with Insurance Regulation 118. Also, the comment requested that Section 98-3.15 of the Proposed Regulation be amended to clarify that the \$500 million premium

threshold be based on December 31st of the prior year, for purposes of the requirement of preparing a report of the MCO's internal control over financial reporting.

The Proposed Regulation had been discussed for several years with the MCOs and the health plan associations, which has provided adequate time for implementation. As previously indicated, the proposed rule is being clarified to allow PHSPs, MLTCs, and HIV SNPs to submit the audited financial statement in accordance with GAAP, with a reconciliation to SAP, in order to align with DFS Regulation 118. The intent of the internal control over financial reporting requirement is based on MCO premiums for prior year ending December 31st. For example, at year end 12/31/2015, the MCO will be required to file the internal control over financial report if total premium reached \$500 million for 2014 as required in the regulation.

Another comment, from Greenberg Traurig, expressed concern that the reporting requirements for HMOs under the Proposed Model Audit Rule Regulation (Proposed 10 NYCRR 98-3) and under DFS Regulation 118 are not the same.

As indicated above, the proposed rule is being clarified to allow PHSPs, MLTCs, and HIV SNPs to submit the audited financial statement in accordance with GAAP, with a reconciliation to SAP, to align with DFS Regulation 118.

A comment from the State Assembly (Richard Gottfried & Kenneth Zebrowski) pointed out that the Proposed Regulation would result in a financial and organizational hardship for PHSPs, HIV SNPs and MLTCs. In addition, the comment requested that the Proposed Regulation be amended to include clarification as provided in a recent DFS Amendment, which requires that whenever a CPA is dismissed or resigns, the MCO must

submit a letter within 15 business days “stating whether there were any disagreements at the decision-making level with the former CPA within the previous 2 years.”

While the Department understands that there will be a cost to plans in implementing the Proposed Regulation, the Department wants to have consistent financial reporting requirements for all plans. The regulation has been clarified in accordance with DFS Regulation 118 which clarifies when the MCO needs to submit a letter to DOH regarding when a CPA is dismissed or resigns.