

**LIFE INSURANCE COMPANY  
OF ALABAMA**

INTERNAL AUDIT REPORT



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Listed below are the internal audit recommendations that were examined in the months of July 2012, August 2012 and September 2012. A summary of suggestions for improvement by control is included for your information. Management may wish to develop a letter of response to this report to detail how items are going to be implemented or that a change will not be placed into operation for a specific suggestion.

Controls tested	<b>Observations by Risk</b>		
	<b>High</b>	<b>Medium</b>	<b>Low</b>
1. Fixed assets			X
2. Accounts payable		X	
3. Cash receipts		X	
4. Investments		X	
5. Income taxes		X	
6. Travel and entertainment policy	X		
7. Internal policies and procedures			X

The report includes our findings, suggestions for improvement and assessed level of risk. Below is the criteria used for the assessment of risk.

**Assessment of Risk:**

**High (H)** – Significant impact to the Company. Individually or aggregately material in terms of financial impact, external compliance violation, adverse publicity, significant or pervasive weakness in control environment, significant inefficiencies, etc.

**Medium (M)** – Moderate in terms of impact to the Company. Individual instance or an aggregate of low risk items considered moderate terms of financial impact, compliance violation, adverse publicity, weakness in control environment, efficiency, etc.

**Low (L)** – Low in terms of impact to the Company. Relatively immaterial in terms of financial impact, no external compliance violation, little adverse publicity, minor inefficiencies, etc.

**Internal Audit Report  
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**Internal Audit Summary Report  
Fixed Assets**

Observations by Risk		
H	M	L
		X

**Background:**

This test was an assessment of the internal controls related to fixed asset. It was included in the internal audit plan due to the importance of having proper capitalization or expensing procedures.

**Scope and Approach:**

Our evaluation included the following procedures related to fixed assets of the Company:

- Developed an understanding of the processes and controls in place for fixed assets by obtaining the Company’s capitalization policy.
- Evaluated the accuracy and completeness of expenses incurred during the first and second quarters of 2012 as they related to fixed assets or repairs and maintenance and verified they were in compliance with the Company’s policy. Evaluates the assets added to the fixed asset detail as being properly capitalized and that asset lives were in compliance with the Company’s capitalization policy.
- Verified that the subsidiary ledger of fixed assets agreed to the general ledger.
- Reviewed all lease agreements currently outstanding for proper treatment as an operating lease or a capital lease.

**Key Highlights:**

- For the first and second quarter of 2012 expenditures described above, no observations were noted.
- For the verification of the subsidiary ledger to the fixed asset schedule for the first and second quarter, no observations were noted.
- For the review of current lease agreements outstanding for proper treatment, no observations were noted.

**Suggestions for Improvement or Observations Noted:**

- **Old or Replaced Equipment:** During the review of the fixed asset subsidiary ledger, it was noted that some of the assets appear to be very old or may have been replaced by newer assets. A detailed review of the subsidiary ledger should be performed each year before property tax filing to verify only assets the Company currently owns or that are in operation are included in those returns.

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Life Insurance Company of Alabama**

**Internal Audit Summary Report  
Fixed Assets**

**Suggestions for Improvement or Observations Noted – Continued:**

- **Proper Description:** The Company’s capitalization policy states that an accurate description of fixed assets be maintained in the subsidiary ledger. While current assets examined included an accurate description, there are several older assets that did not have a proper description. Some assets are labeled “land” or “roof”, with no description as to where these items are located or what asset they represent. Maintaining proper descriptions is crucial if an asset is disposed of or replaced.
- **Add Accounting Procedures to the Policy:** The current capitalization policy does not include the specific accounting procedures applied each quarter. Items that should be added to the policy include the following:
  - All expenses related to fixed assets are first expensed to a repair and maintenance account and those accounts are reviewed quarterly by the controller for any asset that needs to be capitalized.
  - The specific repairs and maintenance accounts reviewed each quarter should be listed in the policy.
  - The policy for depreciating assets should be included. The controller expenses depreciation as follows: (1) the first quarter 25% of the yearly depreciation is expensed (2) the second quarter the next 25% or a total of 50% of the yearly depreciation is expensed (3) the third quarter the next 25% or a total of 75% of the yearly depreciation is expensed (4) the fourth quarter the next 25% or 100% of the yearly depreciation is expensed.
  - The policy for determining if a new lease agreement is operating verse capital should be included in the policy
- **Minutes:** A threshold should be set on the value of a fixed asset or repair that should be approved by the board and included in the minutes.
- **Prepaid Expense Threshold:** During the second quarter’s expense testing it was noted that a prepaid software license expense that would calculate to a prepaid balance of approximately twenty thousand dollars at the end of the year was not capitalized and amortized over the life of the agreement. It has been the Company’s practice not to capitalize such items due to the year end balances being immaterial and this type of asset is considered a non admitted asset under accounting guidance. The accounting guidance states that the recording of a prepaid expense item should follow the general capitalization policy of the Company, which currently is to capitalize any item greater than \$1,000. We suggest adding to the capitalization policy something specific to non admitted prepaid assets to coincide with what the Company is actually doing.

**Internal Audit Report  
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**Internal Audit Summary Report  
Accounts Payable**

Observations by Risk		
H	M	L
	X	

**Background:**

Accounts payable is a critical portion of the Company’s financial records and can be subject to fraud without careful reconciliation and oversight. This test was an assessment of the internal controls related to accounts payable. It was included in the internal audit plan due to the importance of having proper controls over expenses incurred by the Company and proper payment and review procedures.

**Scope and Approach:**

Our evaluation included the following procedures related to the accounts payable of the Company:

- Developed an understanding of the processes and controls in place for accounts payable by obtaining the Company’s cash disbursement policy. Develop an understanding of each key control the Company has over cash disbursements.
- Obtain a detail of all disbursements from account 112200 for the first six months of the 2012 year and sorted the detail by accounts payable checks. Randomly selected 30 checks from general accounts payable expenses and LSP expenses to test for proper key control compliance.
- From the samples selected each significant control area for accounts payable was tested for proper compliance with the policy. Controls tested were as follows:
  - Two staff members approved the invoice.
  - Checks were filed in the electronic system with all required documentation to support the expense.
  - Checks were properly posted to the general ledger and general ledger account selected appeared to be appropriate.

**Key Highlights:**

- For the sample of LSP expenditures selected for the first six months of the 2012 year, no observations were noted.
- For the sample of general accounts payable expenditures selected for the first six months of the 2012 year the following items were noted as suggestions for improvements.
  - Expense that are usually prepared by Katrina, such as filing fees or businesses licenses, are not reviewed by a second person and not scanned to the electronic filing system. We suggest that these items be scanned into the electronic filing system, at least one additional member of management review the expenses and forms completed and someone other than Katrina should mail the checks.

**Internal Audit Report  
Life Insurance Company of Alabama**

**Internal Audit Summary Report  
Accounts Payable**

**Key Highlights —Continued:**

- Expenses that relate to a recurring monthly expense do not require a review signature before payment is processed. This includes items such as water, electricity and phone bills. These types of expense should be reviewed at least quarterly by someone other than the accounts payable person processing the bill for excess usage or possible problems, such as a water leak.

**Suggestions for Improvement or Observations Noted:**

➤ **Suggestions of Additions to the Check Disbursement policy:**

- Include more detail of how invoices are received for payment internally by the accounts payable clerks. How are invoices that are received electronically via email handled?
- Include in the policy how general ledger expense account posting is determined. Is the expense account posting determined by the person reviewing the invoice or by the accounts payable clerk?
- What is the process of making sure an expense item is actually received? Add the Company's policy of obtaining receiving reports for items delivered to the Company that should be matched to an invoice before payment is released.
- Add to the policy that invoices are checked by the accounts payable clerk for mathematical accuracy.
- Add to the policy that invoices are stamped paid and the check number is written on the invoice to avoid duplicate payment.
- Need to add to the policy how duplicate payments are avoided. Examples include making sure each invoice number is entered into the accounting system, stamping all invoices paid, paying amounts based on the invoice amount and not a vendor statement total, and making sure deliver receipts are matched to invoices before payment is remitted.
- What is the policy for approving and setting up vendors? There should also be a policy for looking through the approved vendor list for those the Company no longer does business with and deleting them from the system so a previously approved vendor does not have a false payment made to them.
- What is the policy for proper cut off of expenses and making sure that expenses are recorded in the proper periods?

➤ **Suggestions of Improvements to the Cash Disbursement Policy:**

- If a specific accounts payable clerk enters and processes a check for payment and printing, that person should not mail the checks.

**Internal Audit Report  
Life Insurance Company of Alabama**

**Internal Audit Summary Report  
Cash Receipts**

Observations by Risk		
H	M	L
	X	

**Background:**

This test was an assessment of the internal controls related to accounts receivable/cash collections. It was included in the internal audit plan due to the importance of having proper controls over receipts that are deposited or mailed to the Company.

**Scope and Approach:**

Our evaluation included the following procedures related to cash receipts of the Company:

- Developed an understanding of the processes and controls in place for cash receipts by obtaining the Company’s cash receipt policy. Develop an understanding of each key control the Company has over cash receipts.
- Obtain a detail of all receipts in account 112100 for the first six months of the 2012 year. Randomly selected 30 receipts to test for proper key control compliance. The sample included both ACH and check deposits.
- From the samples selected each significant control area for cash receipts was tested for proper compliance with the policy. Controls tested were as follows:
  - Deposit amount was agreed to supporting documentation and checks deposited were footed with a control tape.
  - Summary control slips were scanned for electronic filing, deposited into the bank account and recorded in the general ledger.
  - ACH and check deposit amount were traced to clearing the bank statement.
  - For deposits that were only checks, checks were footed to the deposit total.
- Reviewed two months bank reconciliations for proper reconciliations and review.

**Key Highlights:**

- The sample of cash receipts selected for the first six months of the 2012 year, no observations were noted.
- During the review of the bank reconciliations there were no observations noted.

**Internal Audit Report  
Life Insurance Company of Alabama**

**Internal Audit Summary Report  
Cash Receipts**

**Suggestions for Improvement or Observations Noted:**

➤ **Suggestions of Improvements to the Cash Receipt Policy:**

- There should be a policy in place for recording and approving interbank transfers.
- Internal control items related to cash receipts:
  - It was noted that the list of daily cash receipts that is compared to the posting of customer accounts and deposits is not done by a person independent of the cash receipts and accounts receivable functions.
  - It was noted that the person that open the mail and makes a list of daily receipts is not independent of the cashier and accounts receivable bookkeeping.
  - Generally the department that handles customer statement complaints is not independent of the preparer of the daily cash receipts list or accounts receivable.
    - The three items noted above could be alleviated by assigning one staff person that does not work in accounts receivable, to open the mail, make a list of daily cash receipts to compare with postings to customer accounts and handle customer complaints.

**Internal Audit Report  
Life Insurance Company of Alabama**

**Internal Audit Summary Report  
Investments**

Observations by Risk		
H	M	L
	X	

**Background:**

This test was an assessment of the internal controls related to investments. It was included in the internal audit plan due to the importance of having proper investment policies and procedures due to the value of the Company's balances.

**Scope and Approach:**

Our evaluation included the following procedures related to investments of the Company:

- Developed an understanding of the processes and controls in place for investments by obtaining the Company's investment policy.
- Agreed each month's postings from the brokerage statement activity to the general ledger until June 2012 and suggest any journal entries.
- Summarized what the Company's policies and procedures are for common stock and bonds and verified that the Company is adhering to their internal policy for those investment currently outstanding as of June 2012.
- Agreed common stock and bond amounts per the brokerage statements to schedule D for the quarter ended June 2012.
- Analyze the bond holdings for any write downs based on a low moody rating of B1 or below and a NAIC rating of 3FE or below. The lower of the cost of the bond or the fair market value was compared to the book value and evaluated for any additional impairment loss.

**Key Highlights:**

- During our review of the Company's policy for investments it was noted that the policy did not include procedures related to approving, recording or reviewing investment transaction. See Appendix A for an investment procedures template that the Company can use as a guide in writing an investment procedures manual.
- During our review of the Company's policy for investments it was noted that it has not been updated since 2006. There were several terminologies in the document that are not longer valid in today's market. See Appendix B for a summary of investment policy guidelines and an example investment policy that may be helpful in updating the current policy and Appendix E for classifications of debt securities from Moody's, S&P and Fitch
- The monthly review of investment transactions resulted in several journal entries that will need to be posted to the general ledger. The differences were the result of investment or dividend postings that did not agree to the statements, foreign taxes not posted, bank fees not posted, corrections of bond costs being posted to the wrong account, small differences in the cost of an investment purchased and the US Bank in transit cash not being posted in the correct period.

**Internal Audit Report  
Life Insurance Company of Alabama**

**Internal Audit Summary Report  
Investments**

**Key Highlights –Continued:**

- Due to the investment policy not using updated terminologies for bond ratings it was difficult to determine if the Company was adhering to their policy. There were several bonds with a low moody rating that may be in violation of the Company’s policy. For common stocks there were several stocks that did not meet the dividend paying requirement or the proper rate of return requirement. There were no stocks held in brokerage accounts that violated the over \$100,000 requirement in the policy.
- There were no significance differences in the comparison of common stock and bond values from the brokerage statements to schedule D. There were some common stocks and bonds that are not held in a brokerage account. The example investment procedures manual and investment policy include notes on how to incorporate these types of investments into the Company’s policies.
- Per the review of bond holdings, there were several bonds that had a Moody rating of B1 or lower and a NAIC rating of 3FE or below. Per our analysis there is a potential for an additional write down of bond values. The Company needs to establish a clear write-down policy and procedure and working papers to support the conclusion. This was also a point that the external examiner made for the Company to incorporate.

**Suggestions for Improvement or Observations Noted:**

- Update the Company’s investment policy.
- Establish an investment procedures manual. There should be clear steps on what the investment committee is in charge of and what steps the outside broker is in charge of. What needs to be prepared, approved, reconciled and reviewed internally.
- Have a time frame established to verify the Company is in compliance with their policy related to investments.
- Need a policy to review bonds for lower of cost or market.
- Need a policy for investments not held by a broker
- Need a policy to receive an audited financial statements and Service Organization Control Report (formerly 70, or SAS 70) from each broker the company does business with.

**Internal Audit Report  
Life Insurance Company of Alabama**

**Internal Audit Summary Report  
Income Taxes**

Observations by Risk		
H	M	L
	X	

**Background:**

This procedure was an assessment of compliance with the Internal Revenue Service and various state agencies regarding the annual income tax liability. It was included in the internal audit plan due to the importance of complying with federal and state law for reporting taxable income and payment of income taxes.

**Scope and Approach:**

Our evaluation included the following procedures related to income tax return preparation of the Company:

- Review Form 1120-L for completeness and accuracy.
- Review various state income tax forms required to be filed.
- Prepare book-to-tax reconciliation for permanent and timing differences and review for completeness.
- Recalculate income tax liability.
- Agree amounts reported on the income tax return with amounts reported on the annual statement and trial balance.

**Key Highlights:**

- Observed a limitation on charitable contribution expenses; corrected classification of specific expenses, reduced the limitation and lowered taxable income by \$25,090.
- Reviewed the depreciation calculation for federal income tax purposes and noted bonus depreciation as allowed for 2011 income tax purposes was not taken; recommended the change in the calculation allowing an additional \$24,043 of depreciation expense.
- As a result of our review and reconciliation of the investment accounts, it was discovered that \$91,315 of interest income was recorded in error and included in book net income; this was eliminated from the taxable income calculation and resulted in a decrease to taxable income of \$91,315.
- Total changes and corrections reduced taxable income by approximately \$140,000, for a federal income tax savings of approximately \$48,000.
- Observed that the deduction for book value of investments in other companies (stock) on the Alabama Privilege Tax return did not include all qualifying stocks; Suggested correction of this deduction and increased the deduction by approximately \$540,000 for an Alabama Privilege Tax savings of approximately \$700.

**Internal Audit Report  
Life Insurance Company of Alabama**

**Internal Audit Summary Report  
Income Taxes**

**Key Highlights –Continued:**

- Federal law requires the payment of the income tax liability on a quarterly basis; at the filing of the 2011 federal income tax return, the amount of tax paid in exceeded the income tax liability by over \$510,000. This overpayment is being appropriately applied to the 2012 tax liability.
- The tax returns are generally due March 15th; Because the independent audit of the financial statements is normally not complete until sometime in May, it has become routine to request extensions of time to file the tax returns (generally until September 15th). However, it is observed that the returns are not being prepared and filed until later in the year (August/September).

**Suggestions for Improvement or Observations Noted:**

- Currently, the income tax returns are prepared internally and are not reviewed by a qualified independent party. Consider the preparation of the income tax returns by an outside firm, or the review of the internally prepared returns by an outside firm. In the case that the Company hires an outside firm to prepare the returns, the returns should also be reviewed by an officer of the company prior to the filing of those returns.
- Taxable income calculations should be prepared on a quarterly basis to insure that the appropriate amount of tax has been paid in for the quarter; Although the overpayment of income taxes can apply to the next year, in the case of the 2011 tax payments over \$500,000 of the company's cash has been held by the Internal Revenue Service for several months. During this time, the company does not earn any interest and loses any potential earning power from those funds.
- Tax returns should be filed as soon as possible; preliminary calculations can be prepared prior to the completion of the audited financial statements so that as soon as the financial numbers are finalized, the tax returns can be prepared and filed.

**Internal Audit Report  
Life Insurance Company of Alabama**

**Internal Audit Summary Report  
Travel and Entertainment Policy**

Observations by Risk		
H	M	L
X		

**Background:**

This test was an assessment of the internal controls related to travel and entertainment. It was included in the internal audit plan due to the importance of having proper controls over the Company's travel and entertainment expenses. This risk for this control is considered high because of the external compliance violations that could occur with the IRS and adverse publicity if the policy is not followed properly.

**Scope and Approach:**

Our evaluation included the following procedures related to the travel and entertainment policy of the Company:

- Developed an understanding of the processes and controls in place for travel and entertainment by obtaining the Company's Travel & Business Expense Reimbursement Policy.
- Obtained a detail of all disbursements from accounts 185-Travel, 818-Entertainment, 817-Meals and 816-Lodging for the first six months of 2012. All expenses posted to these accounts were tested for the following:
  - The expense was submitted for reimbursement no later than 30 days following the completion of a trip.
  - Overall documentation of the expense included names and identity of the individuals present, the business purpose, name and location of where the expense took place, exact amount and date of the expense and receipts for all expenditures
  - Mileage or gas reimbursement should include date and purpose of trip, location traveled to and from, mileage and receipts
  - Meal reimbursement should include name and identity of individuals present, business purpose, name and location of where the meal took place, receipt and date of the expense.
  - Miscellaneous expense reimbursement should include a copy of the receipt, names and identity of individuals present, business purpose and type of expense.
  - An expense report should be submitted by each employee requesting reimbursement and the report should be reviewed and approved.
  - The expense was reviewed for the correct account charged and the expense appeared appropriate.

## **Internal Audit Report Life Insurance Company of Alabama**

### **Internal Audit Summary Report Travel and Entertainment Policy**

#### **Key Highlights:**

Items noted during testing that appeared to not be in compliance with the Company's travel and entertainment policy are detailed below

- What appeared to be a preferred airline tickets and an upgraded hotel room was not reimbursed by the employee for the amount above coach or a standard room.
- Rental car up grades with no clear reason for the upgrade or reimbursement by the employee.
- The following items were reimbursed with no clear business purpose or employee reimbursement: tickets to concerts, spa appointments, spa merchandise, golf games, golf apparel and supplies, city tour, limo services, in-room movies, personal hygiene items and sporting events. The total for these items was approximately \$16,600,
- On average, dinner and lunch meals were \$50 to \$100 per person with some lunches being as high as \$75 per person and dinners being as high as \$220 per person. Receipts given to support these expenses were not detailed to show how much was for food or drinks. The amount expended per day is significantly above the per diem rates set by the US government. Even though the IRS does not state that the per diem rates must be used, those rates may be guidelines that an IRS agent could use to determine if an expense is extravagant. The IRS states the following: "You cannot deduct expenses for meals that are lavish or extravagant. An expense is not considered lavish or extravagant if it is reasonable based on the facts and circumstances. Expenses will not be disallowed merely because they are more than a fixed dollar amount or take place at deluxe restaurants, hotels, nightclubs, or resorts." A detailed receipt would show if the meal was for food only or if high dollar drinks were purchased and would help in determining the reasonable facts and circumstances of the expense.

There were several receipts for "snacks" that appeared to be to lounges or bars before and after dinner and lunch. Several hotel charges were in the hotel bars and lounges. It is unclear if these types of charges are in accordance with the Companies policy that states "Life of Alabama's policy is to refrain from consuming alcoholic beverages during business functions. However, in the event an employee chooses to consume alcoholic beverages in connection with a business function, the Company expects that employees will act responsible and avoid excess."

- The business purpose was not legible on several receipts or expense reports.
- Several in town meals for employees only did not include a clear business purpose.
- Some expense items did not include attached receipts.
- All lodging receipts were classified as lodging in the general ledger even though there were several charges for entertainment and meals included in the receipt. Meals and entertainment expense classified as lodging would not be subject to the 50% deduction rule on the tax return. Approximately \$12,000 in meals and \$8,500 in entertainment was totaled as being included in lodging for the period tested.

**Internal Audit Report  
Life Insurance Company of Alabama**

**Internal Audit Summary Report  
Travel and Entertainment Policy**

**Suggestions for Improvement or Observations Noted:**

- There was approximate \$1,800 in cash tips reimbursed during the six month period with no clear tip guidance in the policy. As these amounts are based on the honesty of the employee and is a cash only transaction, a detailed tip policy should be included in the travel and entertainment policy. The policy should give guidelines for tipping at airports, hotels and restaurants. The employee can tip more than the guideline but will not be reimbursed for the excess.
- A discussion needs to take place if a separate travel and entertainment policy for an employee or an agent should be implemented.
- There needs to be a discussion of the Company reimbursing alcoholic beverages, what is considered appropriate or excess. It could be detailed as to what is appropriate to reimburse employee only meals verses customer entertainment meals.
- Consider receiving detailed receipts of expenses to determine how much of the meal was for alcohol or food.
- Adding to the policy what is considered an unauthorized charge that is subject to employee reimbursement? And who determines if it is unauthorized? Currently the employee requesting reimbursement makes those determinations.
- Who checks that employees have adequate insurance on their cars used for business travel?
- Need to define what a “reasonable” hotel room, airline ticket, rental car, meal or mini bar charge should be.
- What is the policy for golf and spa expenses? These expenses should follow the IRS guidelines for proper business expense; otherwise they need to be reimbursed by the employee.
- What is the policy for entertainment ticket expenses? These expenses should follow the IRS guidelines for proper business expense; otherwise they need to be reimbursed by the employee.
- Need a detailed mileage/auto policy on how expenses will be reimbursed. Based on actual expenses incurred or based on a mileage reimbursement. During testing of these items some were being reimbursed based on actual gas receipts and some based on mileage.
- Determined who completes the amounts for 1099 reporting or reimbursement to the employee. Someone other than the employee should determine these classifications or approve them.
- Making sure that all notes on expense reports that state what the business purpose of an expense is for is legible, if a person’s handwriting cannot be read these individuals should type all notes.

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**Internal Audit Summary Report  
Travel and Entertainment Policy**

- Make a specific policy for in town employee meals that coincide with the IRS guidelines and make sure there is a clear business purpose for the meal and has a legible explanation on the receipt.
- Considering the amount of travel incurred by the Company an agreement with a travel agent, rental car company, hotel chain or airline may be a good idea for better rates. This would result in an agreement between the Company and the agency and would have better guidelines that the company would set for these types of expense instead of leaving the expense reservations, rates and upgrades up to the employee.

For this topic see the following Appendixes for additional guidance or discussion:

Appendix F - Talking Points for a Travel and Entertainment Policy

Appendix G - Example Travel and Entertainment Policy

Appendix H - General IRS Guidelines for Travel and Entertainment

**Internal Audit Report  
Life Insurance Company of Alabama**

**Internal Audit Summary Report  
Internal Policies and Procedures**

Observations by Risk		
H	M	L
		X

**Background:**

This procedure was an assessment of specific internal policies of the Company. It was included in the internal audit plan due to the importance of having proper internal policies. This report may not include all policies or procedures that we may suggest in the future.

**Suggestions for Improvement or Observations Noted:**

- See Appendix C for a suggested example of adding an Internal Audit Charter to the Company’s policies.
- See Appendix D for a suggested example of adding an Internal Audit Policy Statement to the Company’s policies.
- There needs to be a policy for borrowing on behalf of the company. Even though the Company does not currently have long term debt with an outside borrower, there should be a policy in place that address the following:
  - Who has authority to borrow on behalf of the Company.
  - What needs to be approved by the Board.
  - Confirming with banks the company does business with that there are no loans outstanding.
  - Search of public records annually and credit reports for any unknown lending.
- A policy for recording or understanding contingent liabilities that may need to be accrued on the balance sheet should be developed and documented. The policy should include an analysis of legal expenses paid during the year for evidence of work on pending or threatened litigations. Communications with the Company’s attorney regarding any potential lawsuits. Verifying there are no other items that need to be disclosed to the auditors. Some examples are guarantees of other debt, standby letters of credit or other purchase commitments.

**Internal Audit Report  
Life Insurance Company of Alabama**

**Summary of Suggestions for Improvements**

**Fixed Assets**

- A detailed review of the subsidiary ledger to verify only assets the Company currently owns or that are in operation are included in those returns.
- Review subsidiary ledger for proper description of fixed assets.
- Add to the capitalization policy how fixed assets are recorded, the specific repairs and maintenance accounts that are reviewed each quarter, how depreciation expense is recorded each quarter, the policy for lease agreements, a threshold for board approval of fix asset additions and a prepaid expense threshold.

**Accounts Payable**

- Add to the cash disbursement policy detail of how invoices are received for payment internally by the accounts payable clerks, how general ledger expense account posting is determined, the process of making sure an expense item is actually received, the policy that invoices are checked by the accounts payable clerk for mathematical accuracy, the policy that invoices are stamped paid and the check number is written on the invoice to avoid duplicate payment, the policy how duplicate payments are avoided, the policy for approving and setting up vendors and the policy for proper cut off of expenses.
- If a specific accounts payable clerk enters and processes a check for payment and printing, that person should not mail the checks.

**Cash Receipts**

- Add to the cash receipt policy a policy for recording and approving interbank transfers.
- Assign one staff person that does not work in accounts receivable, to open the mail, make a list of daily cash receipts to compare with postings to customer accounts and handle customer complaints.

**Investments**

- Update the Company's investment policy.
- Establish an investment procedures manual.
- Have a time frame established to verify the Company is in compliance with their policy related to investments.
- Need a policy to review bonds for lower of cost or market.
- Need a policy for investments not held by a broker
- Need a policy to receive an audited financial statements and Service Organization Control Report (formerly 70, or SAS 70) from each broker the company does business with.

**Internal Audit Report  
Life Insurance Company of Alabama**

**Summary of Suggestions for Improvements - Continued**

**Income Taxes**

- Consider the preparation of the income tax returns by an outside firm, or the review of the internally prepared returns by an outside firm.
- Taxable income calculations should be prepared on a quarterly basis to insure that the appropriate amount of tax has been paid in for the quarter.
- Tax returns should be filed as soon as possible; preliminary calculations can be prepared prior to the completion of the audited financial statements so that as soon as the financial numbers are finalized, the tax returns can be prepared and filed.

**Travel and Entertainment**

- Adding to the policy the following:
  - Tip policy
  - Employee verses agent reimbursement
  - Alcohol reimbursement policy
  - Receiving detailed receipts
  - What is an unauthorized charge and who determines that
  - Determine “reasonable” amounts for hotel room, airline ticket, rental car, meal or mini bar charge
  - Policy for golf, spa and entertainment tickets and what is appropriate
  - Policy for in town employee only meals
  - Detailed policy on when actual expenses will be reimbursed for gas or mileage
- Who checks that employees have adequate insurance on their cars used for business travel?
- Determined who completes the amounts for 1099 reporting or reimbursement to the employee. Someone other than the employee should determine these classifications or approve them.
- Making sure that all notes on expense reports that state what the business purpose of an expense is for are legible.
- Considering the amount of travel incurred by the Company an agreement with a travel agent, rental car company, hotel chain or airline may be a good idea for better rates.

**Internal Policies and Procedures**

- See Appendix C for a suggested example of adding an Internal Audit Charter to the Company’s policies.
- See Appendix D for a suggested example of adding an Internal Audit Policy Statement to the Company’s policies.
- There needs to be a policy for borrowing on behalf of the company.
- A policy for recording or understanding contingent liabilities that may need to be accrued on the balance sheet should be developed and documented.

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**Appendix A**

**EXAMPLE INVESTMENT PROCEDURES MANUAL**

Key elements of a policy and procedures manual for investments should address the following items:

- Managing Investments
- Managing Derivatives
- Assessing Assets for Impairment

The following are items that should be addressed in the policy and procedures manual:

**Managing Investments**

1. Management reviews the entity's financial statements on a periodic basis and investigates significant variances from budgets and expected results.
  - a. State the person in charge of reviewing the financial statements related to investments.
  - b. State what the benchmark is for investing variances.
2. Interest and dividend income calculation and accruals are reviewed.
  - a. State the person in charge of preparing and reviewing.
3. Third party statements are reconciled to subledger and general ledger accounts and reviewed for accuracy.
  - a. State the person in charge of reconciling the investments to the third party statement and the person in charge of reviewing those reconciliations.
  - b. State the specific checklists that are completed or schedules that are prepared and the software used.
  - c. State how statement or investment information is received by the person in charge of reconciling.
  - d. Also cover any investments or assets that are not managed by a third party and how those are valued and included in the financial statements.
  - e. Detail instructions on how Schedule D is completed should also be addressed.

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**Appendix A - Continued**

4. Investment and derivative activity is reviewed at regular intervals by an appropriate level of management.
  - a. State the person or committee in-charge of reviewing the activity. A reference to the investment policy may also be necessary.
5. Reconciliations are prepared and reviewed in a timely fashion.
  - a. State the person in charge of reconciling the investments and the person in charge of reviewing those reconciliations.
6. Investments are reviewed at acquisition and other appropriate intervals for appropriate classification on the financial statements.
  - a. State the person or committee in charge of this step.
7. Accounting policies and procedures specify the correct treatment for valuing investments and derivatives, including those requiring management estimates and judgments.
  - a. Copy and paste the specific reporting requirements for valuing equities, bonds and other types of investments from the appropriate accounting guidance.
8. A supporting analysis is prepared for valuing investments and derivatives. This analysis documents compliance with the entities accounting policies.
  - a. State the person in charge of this step.
9. Management reviews and approves adjustments to investment and derivative control accounts.
  - a. State the person in charge of making such adjustments and the person responsible for review.

**Managing Derivatives (complete if applicable)**

1. Management reviews the entity's financial statements on a periodic basis and investigates significant variance from budgets and expected results.
  - a. State the person in charge of reviewing the financial statements related to investments.
  - b. State what the benchmark is for investing variances.

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**Appendix A - Continued**

2. Third-party statements are reconciled to subledger and general ledger account(s).
  - a. State the person in charge of reconciling the investments to the third party statements and the person in charge of reviewing those reconciliations.
3. Investment and derivative activity is reviewed at regular intervals by an appropriate level of management.
  - a. State the person or committee in-charge of reviewing the activity. A reference to the investment policy may also be necessary.
4. Management approves investment and derivative transactions to ensure that they are valid and in compliance with the entity's policies and procedures.
  - a. State the person in charge.
5. Accounting policies and procedures specify the correct treatment for valuing investments and derivatives, including those requiring management's estimates and judgments.
  - a. Copy and paste the specific reporting requirements for valuing equities, bonds and other types of investments from the appropriate accounting guidance.
6. A supporting analysis is prepared for valuing investments and derivatives. This analysis documents compliance with the entities accounting policies.
  - a. State the person in charge.
7. Management reviews and approves adjustments to investment and derivatives control accounts.
  - a. State the person in charge.
8. Management monitors agreements to determine that all derivatives are identified and properly accounts for.
  - a. State the person in charge.

**Assessing Assets for Impairment**

1. Management reviews the entity's financial statements on a periodic basis and investigates significant variances from budgets and expected results.
  - a. State the person in charge of reviewing the financial statements related to investments.
  - b. State what the benchmark is for investing variances.

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**Appendix A - Continued**

2. Accounting policies and procedures specify correct treatment for calculating asset impairment, including those requiring management's estimate and judgments.
  - a. A detail of how assets are valued for impairment should be listed.
  - b. State specific on-line or internal tools used during this analysis.
  - c. State the person in charge of analyzing impairment.
3. Recorded assets are reviewed for impairment.
  - a. State the person that is in charge of reviewing the impairment calculation.
4. A supporting analysis is prepared for calculating asset impairment. This analysis document complies with the entities accounting policies.
5. An independent review of significant judgments and estimates included in the financial records is preformed at the end of every accounting period by knowledgeable personnel.
  - a. This may be a member of management or the investment committee.

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**Appendix B**

**INVESTMENT POLICY GUIDELINES**

The most prudent primary objectives for drafting a sound investment policy should be: safety, liquidity, and yield. The investment policy should address certain key questions, including:

- Who are the authorized investment officers?
- What standard of care will be established?
- What instruments will be eligible for investment?
- How will diversification be ensured?
- How will safekeeping be handled?
- What is the maximum term for any given investment?
- What type of internal controls should be in place?
- Who will comprise the investment committee (internal/external members), if any? What are their responsibilities?
- What type of investment reports/performance reports will be produced?
- What types of benchmarks will be used?
- Will an investment advisor be used (and to what capacity)? What are their responsibilities?
- What are the criteria for beginning or ending an investment relationship?
- What happens if an investment fails to meet set criteria?
- How to value investments for reporting purposes?

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**Appendix B - Continued**

**SAMPLE INVESTMENT POLICY**

**I. Introduction**

The intent of the Investment Policy of Life Insurance Company of Alabama is to define the parameters within which funds are to be managed. In methods, procedures and practices, the policy formalizes the framework for the Life Insurance Company of Alabama's investment activities that must be exercised to ensure effective investment management of the Life Insurance Company of Alabama's funds. The guidelines are intended to be broad enough to allow the investment officer and committee to function properly within the parameters of responsibility and authority, yet specific enough to adequately safeguard the investment assets.

The assets of the Company should be invested to provide for the payment of all contractual obligations to policyholders and to contribute to the growth of surplus over the long-term. Therefore, the investment strategy will be based on prudent investment principles within the context of applicable insurance regulations. The strategy will seek to achieve the appropriate balance among: providing investment income to enhance profitability; maintaining liquidity and generating cash flow to meet all obligations; funding policyholder reserves within pricing strategies; and growing the value of surplus over time, thereby contributing to the Company's future growth.

**II. Governing Authority**

The investment program shall be operated in conformance with federal, state, and other legal requirements, including [*insert any applicable NAIC guidelines*].

**III. Scope**

This policy applies to activities of Life Insurance Company of Alabama with regard to investing financial assets. The Life Insurance Company of Alabama diversifies its funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration.

**IV. General Objectives**

The primary objectives, in priority order, of investment activities shall be:

1. *Safety*

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The goal will be to mitigate credit risk and interest rate risk.

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**Appendix B - Continued**

*2. Liquidity*

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. (Can specific a certain % should be liquid or due in one year) The portfolio will be managed to meet the liquidity requirements so as to pay all benefits and expenses in a timely manner.

*3. Return*

The investment portfolio shall be designed with the objective of attaining a market rate of return, taking into account the investment risk constraints of safety and liquidity needs.

**V. Standards of Care**

*1. Prudence*

The standard of prudence to be used by investment officials shall be the “prudent person” standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal liability for an individual security’s credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments. The "prudent person" standard states that, “Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.”

*2. Ethics and Conflicts of Interest*

Officers and employees involved in the investment process shall refrain from personal activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. Disclosure shall be made to the board of directors. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio.

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**Appendix B - Continued**

*3. Delegation of Authority and Responsibilities*

**Governing Body**

The board of directors will retain ultimate fiduciary responsibility for the portfolios. The board of directors will receive monthly reports, designate investment officers and annually review the investment policy making any changes necessary by adoption.

**Investment Officers**

Authority to manage the investment program is granted to the investment committee hereinafter referred to as investment officer as designated by the board of directors. Responsibility for the operation of the investment program is hereby delegated to the [e.g. *Treasurer, Investment Officer, etc.*] who shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this Investment Policy. Officers will prepare monthly investment reports and other special reports as may be deemed necessary. All participants in the investment process shall seek to act responsibly as custodians. No officer or designee may engage in an investment transaction except as provided under the terms of this policy and supporting procedures.

**Investment Adviser**

The Life Insurance Company of Alabama may engage the services of one or more external investment managers to assist in the management of the entity's investment portfolio in a manner consistent with the entity's objectives. Such external managers may be granted discretion to purchase and sell investment securities in accordance with this Investment Policy.

**VI. Authorized Financial Institutions, Depositories, and Broker/Dealers**

*1. Authorized Financial Institutions, Depositories, and Broker/Dealers*

A list will be maintained of financial institutions and depositories authorized to provide investment services. In addition, a list will be maintained of approved security broker/dealers selected by conducting a process of due diligence. These may include 'primary' dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

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**Appendix B - Continued**

A. The investment officer shall determine which financial institutions are authorized to provide investment services to Life Insurance Company of Alabama. Institutions eligible to transact investment business with Life Insurance Company of Alabama include:

- Primary government dealers as designated by the Federal Reserve Bank;
- Nationally or state-chartered banks;
- The Federal Reserve Bank; and,
- Direct issuers of securities eligible for purchase.

B. Selection of financial institutions and broker/dealers authorized to engage in transactions with the Life Insurance Company of Alabama shall be at the sole discretion of Life Insurance Company of Alabama.

C. All broker/dealers who desire to become qualified for investment transactions must supply the following (as appropriate):

- Audited financial statements and Service Organization Control Reports (formerly 70, or SAS 70)
- Proof of FINRA certification
- Proof of state registration
- Certification of having read and understood and agreeing to comply with the Life Insurance Company of Alabama's investment policy.
- Evidence of adequate insurance coverage.

D. All financial institutions who desire to become depositories must supply the following (as appropriate):

- Audited financial statements and Service Organization Control Reports (formerly 70, or SAS 70)
- Proof of state registration
- Evidence of adequate insurance coverage.

E. A periodic review of the financial condition and registration of all qualified financial institutions and broker/dealers will be conducted by the investment officer.

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*2. Competitive Transactions*

A. The investment officer shall obtain competitive bid information on all purchases of investment instruments purchased on the secondary market. A competitive bid can be executed through a bidding process involving at least three separate brokers/financial institutions or through the use of a nationally recognized trading platform.

B. If the Life Insurance Company of Alabama is offered a security for which there is no readily available competitive offering on the same specific issue, then the Investment Officer shall document quotations for comparable or alternative securities. When purchasing original issue instrumentality securities, no competitive offerings will be required as all dealers in the selling group offer those securities as the same original issue price.

C. If the Life Insurance Company of Alabama hires an investment adviser to provide investment management services, the adviser must provide documentation of competitive pricing execution on each transaction. The investment adviser will retain documentation and provide upon request.

**VI. Safekeeping and Custody**

*1. Delivery vs. Payment*

All trades of marketable securities will be executed (cleared and settled) on a delivery vs. payment (DVP) basis to ensure that securities are deposited in the Life Insurance Company of Alabama 's safekeeping institution prior to the release of funds.

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*2. Third-Party Safekeeping*

Securities will be held by an independent third-party safekeeping institution selected by the Life Insurance Company of Alabama. All securities will be evidenced by safekeeping receipts in the Life Insurance Company of Alabama's name. The safekeeping institution shall annually provide a copy of its most recent report on internal controls - Service Organization Control Reports (formerly 70, or SAS 70) prepared in accordance with the Statement on Standards for Attestation Engagements (SSAE) No. 16 (effective June 15, 2011.)

*3. Internal Controls*

Management is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the Life Insurance Company of Alabama are protected from loss, theft or misuse. Specifics for the internal controls shall be documented in an ***investment procedures manual*** that shall be reviewed and updated periodically by the Investment Officers. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived and the valuation of costs and benefits requires estimates and judgments by management. The internal controls shall address the following points at a minimum:

- Control of collusion
- Separation of transaction authority from accounting and recordkeeping
- Custodial safekeeping
- Avoidance of physical delivery securities
- Clear delegation of authority to subordinate staff members
- Written confirmation of transactions for investments and wire transfers
- Dual authorizations of wire transfers
- Staff training and
- Review, maintenance and monitoring of security procedures both manual and automated. The external auditor shall provide an annual independent review to assure compliance with state law, policies and procedures.

*4. Securities held by the Company and not by a Third-Party*

*(as list of securities held by the Company and the specific controls related to those assets should be listed here)*

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**Appendix B - Continued**

**VIII. Suitable and Authorized Investments**

*1. Investment Types and Credit Guidelines*

The following investments will be permitted by this policy:

- U.S. Treasury and other government obligations that carry the full faith and credit guarantee of the United States for the payment of principal and interest.
- Federal Agency or U.S. government sponsored enterprises (GSE) obligations, participations or other instruments
- Federally insured time deposits (Non-negotiable certificates of deposit) in state or federally chartered banks, savings and loans, or credit unions, provided that:
  - a. The amount per institution is limited to the maximum covered under federal insurance;
- Time deposits (Non-negotiable certificates of deposit) in state or federally chartered banks, savings and loans, or credit unions.
- Negotiable certificates of deposit (NCDs)
- Commercial paper, rated in the highest tier (e.g., A-1, P-1, F-1, or D-1 or higher) by a nationally recognized statistical rating organization;
- Investment-grade obligations of state, provincial and local governments and public authorities;
- SEC registered money market mutual funds; and
- *Advice from a stock broker and bond investor should expand this listing to include stocks and bonds*

**IMPORTANT NOTE:** If the credit rating of a security is subsequently downgraded below the minimum rating level for a new investment of that security, the Investment Officer shall evaluate the downgrade on a case-by-case basis in order to determine if the security should be held or sold. The Investment Officer will apply the general objectives of safety, liquidity, yield and legality to make the decision.

*2. Collateralization*

Where allowed or required by state law and in accordance with full collateralization will be required on all demand deposit accounts, including checking accounts and negotiable (as authorized by respective state statutes) and non-negotiable certificates of deposit.

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**Appendix B - Continued**

**IX. Investment Parameters**

1. Mitigating credit risk in the portfolio

Credit risk is the risk that a security or a portfolio will lose some or all of its value due to a real or perceived change in the ability of the issuer to repay its debt. The Life Insurance Company of Alabama shall mitigate credit risk by adopting the following:

*A. Diversification*

The investments shall be diversified by:

- limiting investments to avoid overconcentration in securities from a specific issuer or business
- sector (excluding U.S. Treasury securities),
- limiting investment in securities that have higher credit risks,
- investing in securities with varying maturities, and
- *list any other diversification items*

*B. Mitigating market risk in the portfolio*

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The Life Insurance Company of Alabama recognizes that, over time, longer-term/core portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The Life Insurance Company of Alabama shall mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer-term investments only with funds that are not needed for current cash flow purposes. The Life Insurance Company of Alabama further recognizes that certain types of securities, including variable rate securities, securities with principal pay downs prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The Life Insurance Company of Alabama, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

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- The Life Insurance Company of Alabama shall maintain a minimum of *(insert time frame)* months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements;
- The maximum percent of callable securities in the portfolio shall be *xx%*;
- The maximum stated final maturity of individual securities in the portfolio shall be *xxx* years, except as otherwise stated in this policy; and,
- *List any other factors as needed or suggested by the investment broker*

**X Performance Standards/ Evaluation**

The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio should obtain a market average rate of return during a market/economic environment of stable interest rates. A series of appropriate benchmarks shall be established against which portfolio performance shall be compared on a regular basis. The benchmarks shall be reflective of the actual securities being purchased and risks undertaken and the benchmarks shall have a similar weighted average maturity and credit profile as the portfolio.

**XI. Reporting/Disclosure**

*1. Methods*

The investment officer shall prepare an investment report at least quarterly *[or monthly]*, including a management summary that provides an analysis of the status of the current investment portfolio and the individual transactions executed over the last quarter *[or month]*. This management summary will be prepared in a manner which will allow the Life Insurance Company of Alabama to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report should be provided to the Life Insurance Company of Alabama's investment committee. The report will include, at a minimum, the following (the following reports can be submitted internally or through a third party administrator):

- a. An asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate;
- b. Average maturity of the portfolio and modified duration of the portfolio;

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- c. Maturity distribution of the portfolio;
- d. Average portfolio credit quality; and,
- e. Time-weighted total rate of return for the portfolio for the prior one month, three months, twelve months, year to date, and since inception compared to the Benchmark Index returns for the same periods;
- f. Average weighted yield to maturity of portfolio on investments as compared to applicable Benchmarks
- g. Distribution by type of investment.

*2. Annual reports*

1 The investment policy shall be reviewed at least annually within 120 days of the end of the fiscal year to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends.

2. A comprehensive annual report shall be presented in conjunction with the investment policy review. This report shall include comparisons of Company's return to the Benchmark Index return, shall suggest policies and improvements that might enhance the investment program, and shall include an investment plan for the coming year.

*3. Annual audit*

Management shall establish an annual process of independent review by the external or internal auditor(s) to assure compliance with internal controls. Such audit will include tests deemed appropriate by the auditor.

*4. Exemption*

Any investment currently held that does not meet the guidelines of this policy shall be temporarily exempted from the requirements of this policy. Investments must come in conformance with the policy within six months of the policy's adoption or the governing body must be presented with a plan through which investments will come into conformance. *(or list any specific exemptions for investments that do not meet this policy)*

*5. Amendments*

This policy shall be reviewed on an annual basis. Any changes must be approved by the investment officer and any other appropriate authority, as well as the individuals charged with maintaining internal controls.

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6. *Valuation*

The market value of the portfolio shall be calculated at least quarterly [or monthly] and a statement of the market value of the portfolio shall be issued at least quarterly or monthly]. This will ensure that the review of the investment portfolio, in terms of value and price volatility has been preformed. Securities should be reviewed for impairment on a quarterly basis so that the securities which are found to be impaired are reported at fair value at the time of impairment.

**XIV Approval of Investment Policy**

The investment policy and any modifications to that policy shall be formally approved and adopted by the board of directors of the Life Insurance Company of Alabama.

**XV. Miscellaneous**

*1. List of Attachments*

The following documents, as applicable, are attached to this policy:

- Listing of authorized personnel,
- Relevant investment statutes and ordinances,
- Listing of authorized broker/dealers and financial institutions,
- Internal Controls

*2. Other Documentation*

- Broker-dealer certification
- Safekeeping agreements,
- Wire transfer agreements,
- Sample investment reports,
- Bonding of employees handling investments
- Audited financial statements of broker/dealers and financial institutions
- Service Organization Control Reports (formerly 70, or SAS 70) from broker/dealers and financial institutions

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**Appendix C**

**EXAMPLE INTERNAL AUDIT CHARTER**

**INTRODUCTION:**

Internal auditing is an independent and objective assurance and consulting activity that is guided by a philosophy of adding value to improve the operations of Life Insurance Company of Alabama. It assists Life Insurance Company of Alabama in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the organization's risk management, control and governance processes.

**ROLE:**

The internal audit activity is established by the board of directors or oversight body (hereafter referred to as the board). The internal audit activity's responsibilities are defined by the board as part of their oversight role.

**PROFESSIONALISM:**

The internal audit activity will govern itself by adherence to The IIA's mandatory guidance, including the Definition of Internal Auditing, the Code of Ethics, and the *International Standards for the Professional Practice of Internal Auditing (Standards)*. This mandatory guidance constitutes principles of the fundamental requirements for the professional practice of internal auditing and for evaluating the effectiveness of the internal audit activity's performance.

The internal audit activity will adhere to Life Insurance Company of Alabama's relevant policies and procedures and the internal audit activity's standard operating procedures manual.

**AUTHORITY:**

The internal audit activity, with strict accountability for confidentiality and safeguarding records and information, is authorized full, free and unrestricted access to any and all of Life Insurance Company of Alabama's records, physical properties, and personnel pertinent to carrying out any engagement. All employees are required to assist the internal audit activity in fulfilling its role and responsibilities. The internal audit activity will also have free and unrestricted access to the board.

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**Appendix C - Continued**

**ORGANIZATION:**

The chief audit executive (CAE) and/or external CPA firm will report functionally to the board and administratively (i.e. day-to-day operations) to the CEO.

The board will approve all decisions regarding the performance evaluation, appointment, or removal of the CAE and/or external CPA firm as well as the CAE's annual compensation and salary adjustment and/or external CPA firm's fees. The CAE and/or external CPA firm will communicate and interact directly with the board, including in executive sessions and between board meetings as appropriate.

**INDEPENDENCE AND OBJECTIVITY:**

The internal audit activity will remain free from interference by any element in the organization, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of a necessary independent and objective mental attitude.

Internal auditors will have no direct operations responsibility or authority over any of the activities audited. Accordingly, they will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair the internal auditor's judgment.

Internal auditors must exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors must make a balanced assessment of all the relevant circumstances and not be unduly influenced by their own interests or by other in forming judgments.

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**Appendix C - Continued**

**RESPONSIBILITY:**

The scope of internal auditing encompasses, but is not limited to, the examination and evaluation of the adequacy and effectiveness of the organization's governance, risk management, and internal process as well as the quality of performance in carrying out assigned responsibilities to achieve the organization's stated goals and objectives. This includes:

- Evaluating the reliability and integrity of information and the means used to identify, measure, classify, and report such information.
- Evaluating the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations that could have a significant impact on the organization.
- Evaluating the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
- Evaluating the effectiveness and efficiency with which resources are employed.
- Evaluating operating or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.
- Monitoring and evaluating governance processes.
- Monitoring and evaluating the effectiveness of the organization's risk management processes.
- Evaluating the quality of performance of external auditors and the degree of coordination with internal audit.
- Performing consulting and advisory services related to governance, risk management, and control as appropriate of the organization.
- Reporting periodically on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan.
- Reporting significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by the board.
- Evaluating specific operations at the request of the board or management, as appropriate.

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**Appendix C - Continued**

**INTERNAL AUDIT PLAN:**

At least annually, the CAE or external CPA firm will submit to senior management and the board an internal audit plan for review and approval. The internal audit plan will consist of a work schedule as well as budget and resource requirements for the next fiscal/calendar year. The CAE or external CPA firm will communicate the impact of resource limitations and significant interim changes to senior management and the board.

The internal audit plan will be developed based on a prioritization of the audit universe using a risk-based methodology, including input of senior management and the board. Any significant deviation from the approved internal audit plan will be communicated to senior management and the board through periodic activity reports.

**REPORTING AND MONITORING:**

A written report will be prepared and issued by the CAE or external CPA firm or designee following the conclusion of each internal audit engagement and will be distributed as appropriate. Internal audit results will also be communicated to the board. The internal audit report may include management's response and corrective action taken or to be taken in regard to the specific findings and recommendation. Management's response, whether included within the original audit report or provided thereafter (i.e., within 30 days) by management of the audited area should include a timetable for anticipated completion of action to be taken and an explanation for any corrective action that will not be implemented.

The internal audit activity will be responsible for appropriate follow-up on engagement findings and recommendations. All significant findings will remain in an open issues file until cleared.

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**Appendix C - Continued**

**PERIODIC ASSESSMENT:**

The CAE or external CPA firm will periodically report to senior management and the board on the internal audit activity's purpose, authority, and responsibility, as well as performance relative to its plan. Reporting will also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the board.

**INTERNAL AUDIT ACTIVITY CHARTER**

Approved this \_\_\_\_\_ day of \_\_\_\_\_, \_\_\_\_\_.

\_\_\_\_\_  
Chief Audit Executive or Representative of external CPA firm

\_\_\_\_\_  
Chief Executive Officer

\_\_\_\_\_  
Chairman of the Board of Directors

\_\_\_\_\_  
Chairman of the Audit Committee

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**Appendix D**

**EXAMPLE INTERNAL AUDIT POLICY STATEMENT**

It is the policy of this organization to establish and support an internal audit activity as an independent appraisal function to examine and evaluate organization activities as a service to management and the board of directors. The internal audit activity reports administratively to senior management and functionally to the audit committee of the board of directors. In carrying out their duties and responsibilities, members of the internal audit activity will have full, free and unrestricted access to all organization activities, records, property and personnel.

The primary objective of the internal audit activity is to assist members of management and the board in the effective discharge of their responsibilities. To this end, internal audit will furnish them with analyses, recommendations, counsel, and information concerning the activities reviewed.

The missions of the internal audit activity are:

1. Review business units within the entity at appropriate intervals to determine whether they are efficiently and effectively carrying out their functions of planning, organizing, directing and controlling in accordance with management instructions, policies and procedures, and in a manner that is consistent with both organization objectives and high standards or administrative practice.
2. Determine the adequacy and effectiveness of the organization's systems of internal accounting and operating controls.
3. Review the reliability and integrity of financial and operating information and the means used to identify, measure, classify and report such information.
4. Review the established systems to ensure compliance with those policies, plans, procedures, laws, and regulations that could have a significant impact on operations and reports, and determine whether the organization is in compliance. Suggest policy where required.
5. Review the means of safeguarding assets and, as appropriate, verify the existence of such assets.

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**Appendix D - Continued**

6. Appraise the economy and efficiency with which resources are employed, identify opportunities to improve operating performance, and recommend solutions to problems where appropriate.
7. Review operations and programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.
8. Provide adequate follow-up to make sure that appropriate corrective action is taken and that it is effective.
9. Coordinate audit efforts with those of the organization's external auditors.
10. Participate in the planning, design, development, implementation, and operation of major computer-based systems to determine whether:
  - Adequate controls are incorporated in the systems.
  - Through system testing is performed at appropriate stages.
  - System documentation is complete and accurate.
  - The needs of user organizations are met.

Conduct periodic audits of computer service centers and make post-installations evaluations of major data processing systems to determine whether these systems meet their intended purposes and objectives.

11. Participate in the planning and performance of audits of potential acquisitions with the organization's outside accountants and other members of the corporate staff. Follow up to assure the proper accomplishment of the audit objectives.
12. Review compliance with the organization's guidelines for ethical business conduct and see that the highest standards of personal and corporate performance are met.
13. Submit annual audit plans to the president and the board of directors, including the audit committee, for their review and approval.

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**Appendix D - Continued**

14. Report every quarter to the board of directors (the audit committee, if so directed) as to whether:
- Appropriate action has been taken on significant audit observations.
  - Audit activities have been directed toward the higher exposures to risk and toward increasing efficiency, economy and effective operations.
  - Internal and external audits are coordinated as to avoid duplications.
  - Internal audit plans are adequate.
  - There is any unwarranted restriction on the staffing and authority of the internal audit activity or on access by internal auditors to all organization activities, records, property and personnel.
15. Report to those members of management who should be informed or who should take corrective action, the results of audit examinations, the audit opinions formed, and the recommendations made.
16. Evaluate any plans or actions taken to correct reported conditions for satisfactory disposition of audit observations. If the corrective action is considered unsatisfactory, hold further discussions to active acceptable disposition. The business unit manager is responsible for seeing that corrective action on reported weaknesses is either planned or taken within 30 days from receipt of a report disclosing those weaknesses. The business unit manager is also responsible for seeing that a written report of action planned or completed is sent to the applicable member of senior management. If a plan for action is reported, a second report shall be made promptly upon completion of the plan.
17. Evaluate the activities of the external auditors as to their independence and compliance with generally accepted audit standards.

**Approval:**

\_\_\_\_\_  
Chair of the Audit Committee or President of the Board of Directors

\_\_\_\_\_  
Date

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**Appendix E - Debt Securities Credit Rating Chart for Moody's, S&P and Fitch**

Moody's		S&P		Fitch			
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term		
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime	
Aa1		AA+		AA+		High grade	
Aa2		AA		AA			
Aa3		AA-		AA-			
A1	P-2	A+	A-1	A+	F1	Upper medium grade	
A2		A		A			
A3		A-	A-2	A-	F2	Lower medium grade	
Baa1	BBB+	BBB+					
Baa2	P-3	BBB	A-3	BBB	F3	Lower medium grade	
Baa3		BBB-		BBB-			
Ba1	Not prime	BB+	B	BB+	B	Non-investment grade speculative	
Ba2		BB		BB			
Ba3		BB-		BB-			
B1		B+		B+		Highly speculative	
B2		B		B			
B3		B-		B-			
Caa1		C	CCC+	C	CCC	C	Substantial risks
Caa2			CCC				Extremely speculative
Caa3			CCC-				Default imminent with little prospect for recovery
Ca		CC					
C	C	D	/	DDD	/	In default	
/	DD						
/	D						

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Moody's	Standard & Poor's	Fitch	Credit worthiness
Aaa	AAA	AAA	An obligor has EXTREMELY STRONG capacity to meet its financial commitments.
Aa1	AA+	AA+	An obligor has VERY STRONG capacity to meet its financial commitments. It differs from the highest rated obligors only in small degree.
Aa2	AA	AA	
Aa3	AA-	AA-	
A1	A+	A+	An obligor has STRONG capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.
A2	A	A	
A3	A-	A-	
Baa1	BBB+	BBB+	An obligor has ADEQUATE capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments.
Baa2	BBB	BBB	
Baa3	BBB-	BBB-	
Ba1	BB+	BB+	An obligor is LESS VULNERABLE in the near term than other lower-rated obligors. However, it faces major ongoing uncertainties and exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitments.
Ba2	BB	BB	
Ba3	BB-	BB-	
B1	B+	B+	An obligor is MORE VULNERABLE than the obligors rated 'BB', but the obligor currently has the capacity to meet its financial commitments. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitments.
B2	B	B	
B3	B-	B-	
Caa	CCC	CCC	An obligor is CURRENTLY VULNERABLE, and is dependent upon favorable business, financial, and economic conditions to meet its financial commitments.
Ca	CC	CC	An obligor is CURRENTLY HIGHLY-VULNERABLE.
	C	C	The obligor is CURRENTLY HIGHLY-VULNERABLE to nonpayment. May be used where a bankruptcy petition has been filed.
C	D	D	An obligor has failed to pay one or more of its financial obligations (rated or unrated) when it became due.
e, p	pr	Expected	Preliminary ratings may be assigned to obligations pending receipt of final documentation and legal opinions. The final rating may differ from the preliminary rating.
WR			Rating withdrawn for reasons including: debt maturity, calls, puts, conversions, etc., or business reasons (e.g. change in the size of a debt issue), or the issuer defaults.
unsolicited	unsolicited		This rating was initiated by the ratings agency and not requested by the issuer.
	SD	RD	This rating is assigned when the agency believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner.
NR	NR	NR	No rating has been requested, or there is insufficient information on which to base a rating.

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**Appendix F - Talking Points for a Travel and Entertainment Policy**

**Before you begin you should ask yourself these questions:**

- ✓ Who should be subject to the travel policy and should it apply equally to all levels of employees?
- ✓ How forceful should the policy be?
- ✓ Should there be an international policy or should each country have its own policy?
- ✓ Should there be separate policies for employees and 1099 agents?

**Expense Reporting considerations:**

- ✓ What are the requirements for attaching receipts to expense reports?
- ✓ What receipts are acceptable?
- ✓ When must travelers file expense reports?
- ✓ On what form should employees report their expenses?

**Payment Methods:**

- ✓ How should employees pay for travel and entertainment expenditures?
- ✓ How are corporate charge card expenses to be billed?
- ✓ Which employees should receive corporate cards? And what expenses are acceptable on those cards?
- ✓ Corporate cards should not be used to pay for personal expenses when it presents potential liability.
- ✓ Determine at what level senior executives should receive Executive / VIP / Gold corporate cards.
- ✓ Advise travelers on procedures for how to obtain a card and what to do in the event of a lost or stolen card.

**Air Travel considerations:**

- ✓ What are the parameters for airfare expense?
- ✓ If the company or its agency has negotiated discounts with preferred airlines, to what extent is use of such airlines superior or subordinate to other factors in this section?
- ✓ Does the company retain rights to the frequent flyer awards earned by employees traveling on company business?
- ✓ Will exceptions to air travel policy be allowed in response to travelers' concerns about safety or service?

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**Car Rental considerations:**

- ✓ Do you have a preferred supplier?
- ✓ What size or class of cars should be rented?
- ✓ How should reservations be made?
- ✓ Under what circumstances might policy suggest or require that rental cars be used or not used?
- ✓ Should drivers purchase accidental insurance or liability coverage for personal effects?
- ✓ Outline a procedure for the traveler should there be an accident.

**Hotel policy considerations:**

- ✓ How should hotel rooms be booked?
- ✓ How much should employees pay for hotel rooms?
- ✓ What other limitations should be placed on hotel usage?
- ✓ Under what circumstances can employees stay in better-quality properties or book higher-rated rooms than ordinarily would be permitted?

**Meal and Entertainment:**

- ✓ How much are traveling employees allowed to spend on personal meals?
- ✓ Will alcohol for non-customer meals be reimbursed?
- ✓ Specify what personal meal expenses may not be reimbursable.
- ✓ Outline the difference between personal, business and entertainment meals.

**Additional information:**

- ✓ Include exceptions to the policy and what steps will be taken when employees violate the policy.

**Policy distribution:**

- ✓ How should the policy be distributed?
- ✓ To whom should the policy be distributed

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**Appendix G - Example Travel and Entertainment policy**

**LIFE INSURANCE COMPANY OF ALABAMA TRAVEL AND  
ENTERTAINMENT POLICY**

Following is the new **Life Insurance Company of Alabama Travel & Business Expense Reimbursement Policy**. This manual contains additional guidance and revised limits for all travel & entertainment. Among the changes is the establishment of a travel assistant and a new Expense Report. As such, please take some time to review the policy as these changes (and others) are effective immediately.

While we all hope that our experiences conducting business on behalf of Life Insurance Company of Alabama are pleasurable and gratifying, we also must be reasonable. This policy will reflect our collective responsibility to conduct business in a fiscally responsible manner

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General Guidelines

Reporting Guidelines

Travel Authorization

Logging Your Expenses

Authorization Process

Tips For the New Expense Reporting Template

**General Guidelines**

These policies and procedures are designed to act as a guideline for business travel and entertainment expense and miscellaneous expense reimbursements. They are based on practices employed by most organizations of our size and take into consideration what is considered reasonable and customary. While this handbook does contain suggested expense limits, we challenge all employees to use professional judgment when incurring expenses on behalf of the Company. Life Insurance Company of Alabama recognizes that, in some isolated cases, business related expenses might need to be reviewed on a case-by-case basis; however, this primarily applies if the expense in question was not discussed in this policy.

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This policy is designed to accomplish the following key points:

- Ensure all employees have a clear and consistent understanding of policies and procedures for business travel and expenses.
- Ensure employees are reimbursed for legitimate business travel and entertainment expenses.
- Provide employees who must travel with a reasonable level of service and comfort at the lowest possible cost.
- Maximize the company's ability to negotiate discounted rates with preferred suppliers and reduce travel expenses.
- Provide the appropriate level of accounting and business controls for the company to ensure that expenses are reviewed and approved by the appropriate person.

**Responsibility**

The traveler is responsible for complying with Life Insurance Company of Alabama Travel Policies. The manager who approves and signs expense reports is responsible for accurately reviewing expense reports for compliance. Life Insurance Company of Alabama will reimburse employees for all **reasonable** and **necessary** expenses while traveling on authorized company business or entertaining business clients. Life Insurance Company of Alabama assumes no obligation to reimburse employees for expenses that are not in compliance with this policy. Life Insurance Company of Alabama's Controller must approve any deviation from this policy.

**Enforcement**

Employees who do not comply with this policy may be subject to delay or withholding of reimbursement and/or, disciplinary action.

**Alcoholic Beverages**

Life Insurance Company of Alabama's policy is to refrain from consuming alcoholic beverages during business functions. However, in the event an employee chooses to consume alcoholic beverages in connection with a business function, the Company expects that employees will act responsibly and avoid excess. If an employee has any concerns that he/she is not capable of safely driving after such events, the Company will reimburse the cost of alternative transportation to ensure that the employee does not place themselves or others in danger. An employee, who is arrested and convicted for Driving Under the Influence while in the performance of company business, or when returning from a business function, is subject to disciplinary action up to and including termination.

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**REPORTING GUIDELINES**

Employees must file expense reports no later than 30 days following the completion of the trip or of incurring the expense. Expenses must be submitted for reimbursement within 3 months of being incurred, or they will not be reimbursed.

**Documentation Requirements**

Employees must provide the following information in order to be reimbursed for any business related meals or entertainment expenditures:

- Names of individuals present, their titles and company name
- Name and location of where the meal or event took place
- Exact amount and date of the expense
- DETAILED receipts for all entertainment expenditures in excess of \$25.00.
- DETAILED receipts for meals, in excess of \$25.00.

Employees must submit the following documentation with their Expense Report:

- Air/Rail – original passenger receipt.
- Hotel – hotel folio plus credit card receipt or other proof of payment.
- Car Rental – credit card receipt or rental agency invoice.
- Entertainment – credit card receipt and detailed register receipt for all expenses over \$25.00.
- Meals – credit card receipt and detailed register receipts for meal expenses over \$25.00, if a detailed receipt is available.

Please note: credit card statements are not considered an acceptable form of receipt.

Receipts must be affixed to a piece of paper with like items (e.g. cabs) together. An explanation of the business expense and a list of the individuals/company affiliations entertained (in the case of meal/entertainment receipts) must be documented next to the original receipt.

If like items have been summed to arrive at a single figure for entry to a single cell on the expense report, please indicate which items are being totaled on the paper where the receipts are affixed. Expense reports containing entries that cannot easily be supported by receipts will be returned to the person submitting the expense report.

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When a receipt is not available, a full explanation of the expense and the reason for the missing receipt is required. Actual bills/receipts must be submitted whenever possible; photocopies will be acceptable only with a detailed explanation as to why the original is unavailable. Receipts must include the name of the vendor, location, date and dollar amount. All expenses must be reported, regardless of how they were paid. The following receipts are acceptable:

- Original receipt completed by the vendor
- Customer's copy of credit card slip
- Credit card billing statement, only in the unusual case where it is not possible to obtain the actual receipt
- Original phone bill
- IRS-approved electronic ticket receipt

**Incorrect or Incomplete Expense Reports**

Expense reports that are incorrect, incomplete or include disorganized receipts:

- Will be returned to the approver for completion.
- May result in delay or non-reimbursement of specific items.

Disregard for company policy or altering of receipts can result in disciplinary action up to and including termination.

**LOGGING YOUR EXPENSES**

Effective immediately, employees must complete the new Life Insurance Company of Alabama Expense Report for reimbursement of expenses.

**Air/Rail Travel**

Air travel reservations should be made in such a manner as to secure the best available fare. Available resources include, but are not limited to: travel agents, online resources or directly with the airline. (Please see the Tips For the New Expense Report section below for additional information.) ALL AIR TRAVEL MUST BE IN COACH CLASS.

When traveling by air:

- Employees are expected to use the lowest logical airfare available.
- Employees should consider Saturday night stays and stays exceeding 3 days
- Employees are expected to reserve 7-day advance notice purchases.
- Employees are expected to use non-direct flights when the savings are substantial.
- Obtain **CEO/CFO** approval for all trips over \$2,000.
- Obtain **CEO/CFO** approval for all International travel

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**Upgrades for Air Travel**

Upgrades for air travel are not reimbursable. If an employee wishes to upgrade, it is done at the employee's expense.

**Cancellations**

When a trip is cancelled after the ticket has been issued, the traveler should inquire about using the same ticket for future travel. Employees should reuse airline tickets if: a) they are traveling on the same route, or b) airfare eligibility requirements (verified with travel agent) are met.

**Unused/Voided Airline Tickets**

Unused airline tickets or flight coupons must never be discarded or destroyed as these documents may have a cash value. To expedite refunds, unused or partially used airline tickets must be returned immediately to the issuing authority. Employees must NOT include unused tickets with their expense reports. Employees with an electronic ticket simply need to call the travel agent/issuing authority to initiate a refund.

**Lost or Stolen Airline Tickets**

Immediately upon discovery of a lost/stolen ticket, the traveler must:

- Report the loss to the travel agent/issuing authority who will file the lost ticket application
- Fill out a lost ticket application at the airline ticket counter.

**Airport and Train Station Parking**

When parking at an airport or train station is part of business travel, it is expected that employees will utilize Long Term parking lots. Short Term parking fees will not be reimbursed.

**Auto Travel: Car Rental**

Employees may rent a car to get to their destination when driving is more cost effective than airline or rail travel. Employees may rent a car at their destination when it is less expensive than other transportation modes such as taxis, airport limousines and airport shuttles or when entertaining customers. Whenever multiple employees are traveling together, every effort to rideshare or carpool must be made.

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Employees must reserve a car in the compact rental car category. When picking up a rental car, check with the rental car agent for any promotional rates, last-minutes specials or free upgrades. At the time of rental, inspect the car and be sure that any damage found is noted on the contract before the vehicle is accepted. When plans change, employees are responsible for working with their Travel Assistant to cancel rental car reservations. Employees may book a car rental class of service one level higher when:

- The traveler can be upgraded at no extra cost
- Two or more company employees are traveling together
- Entertaining customers
- Cars in the authorized category are not available
- Transporting excess baggage such as booth displays.

Domestic travelers should always accept the collision insurance offered by rental agencies but should decline all other offered insurances. International travelers should accept all insurances offered. Additionally, whenever possible, the prepaid gas option should be declined.

Rental cars must be returned as follows:

- To the original rental city unless approved for a one-way rental
- Intact (i.e. no bumps, scratches, or mechanical failures)
- On time, to avoid additional hourly charges
- With a full tank of gas.

Should a rental car accident occur, employees should immediately contact the rental Car Company, local authorities (as required), and the Human Resources Department.

**Rental Car Gas**

Gasoline for use in rental cars is reimbursable with proper documentation. Make sure to log this expense as AUTO RENTAL & GAS.

**Cell Phone Use While Driving**

Use of a cell phone while driving is not recommended in any situation and employees are expected to refrain from using their phone while driving. Texting while driving is prohibited. Employees are strongly encouraged to pull off to the side of the road and safely stop the vehicle before placing or accepting a call. If acceptance of a call is unavoidable and pulling over is not an option, employees are expected to keep the call short. Life Insurance Company of Alabama strictly prohibits employees from using a cell phone without a hands-free device while driving.

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**Taxi / Shuttle / Parking Fees**

The use of airport shuttles and taxis upon arrival at the employee's destination is the preferred mode of transportation. Make sure to ask for a receipt if one is not offered. This documentation aids in the expense-tracking process.

**Business Use of Personal Vehicle**

Employees may use their personal vehicle for business purposes if it is less expensive than renting a car, taking a taxi, or using alternate transportation. Personal vehicles may also be used when transporting company goods for delivery or entertaining clients. It is the personal responsibility of the vehicle owner to carry adequate insurance coverage for their protection and for the protection of any passengers. Life Insurance Company of Alabama requires that employees who regularly use their personal vehicle for Company business maintain minimum of \$100,000/\$300,000 bodily injury coverage and \$50,000 property damage coverage on their vehicles. Mileage is reimbursed at the rate established by the IRS (\$.555/mile for 2012). This mileage allowance is in lieu of actual expenses for gasoline, oil, repairs, tags, insurance, and depreciation. Therefore, actual expenses for those items will not be reimbursed when your personal vehicle is used for business. To be reimbursed for the use of your personal vehicle for business, employees must list on the expense report:

- Date and purpose of the trip
- Locations traveled to and from
- Mileage

**Lodging / Hotel**

Hotel reservations should be made in such a manner as to secure the best available rate and must be booked through the assistance of a Travel Assistant. Employees are required, whenever possible, to use properties in the Moderate category.

In case of cancellation:

- Employees are responsible for working with their Travel Assistant or hotel to cancel the reservation.
- Employees will be held responsible and will not be reimbursed for "no-show" charges unless there is sufficient proof that the billing is in error or circumstances were beyond the traveler's control.
- Employees should request and record the cancellation number in case of billing disputes.
- Employees should note that cancellation deadlines are based on the local time of the property.

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**Meals**

Personal meals are defined as meal expenses incurred by the traveler when dining alone on an out-of-town business trip. Approximate meal expense guidelines are as follows:

- \$20/day for breakfast and lunch combined
- \$30 to \$40/day for dinner.
- For guidelines for out of state meals please use the website <http://www.gsa.gov/portal/category/21287> for the Per Diem rates set by the U.S. General Service Organization.

**Business Meals Taken With Other Employees**

Employees will be reimbursed for business-related meals taken with other employees only in the following circumstances:

- When a client is present
- When at least one company employee is from out of town
- When, for confidentiality reasons, business must be conducted off company premises

The following documentation is required by the IRS, and must be recorded on the expense report:

- Names of individuals present, their titles and company name,
- Name and location of where the meal or event took place,
- Exact amount and date of the expense.

Please note that employees will not be reimbursed for entertaining other employees unless there is a direct reporting relationship between them.

**Telephone Expenses:**

**Business Phone Calls**

Employees will be reimbursed when using their personal cellular telephone, calling cards or home phone for business related phone calls:

- Which are reasonable and necessary for conducting business
- With an original copy of the bill attached to the expense report form.

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**Personal Phone Calls While Traveling**

Employees will be reimbursed for personal telephone calls while traveling on business:

- Not to exceed \$20.00/day for domestic travel
- Not to exceed \$50.00/day for international travel.

In all cases, employees are responsible for securing and utilizing the most reasonable long-distance calling option available.

**Hotel Telephone Usage**

When staying at a hotel, employees should find out the property's local and long distance phone rates. Employees should avoid making phone calls that have an added surcharge.

**Miscellaneous Expenses**

The Miscellaneous column is designated for expenses that do not fit into the previous categories, yet are directly business related and therefore reimbursable. ONLY the following items can be considered as reimbursable business expenses:

- Office services (i.e. faxes, copies, overnight delivery / postage)
- Currency conversion fees
- Business gifts of reasonable value with prior management approval
- Laundry / Dry Cleaning / Suit Pressing for trips exceeding 3 days
- Seminar fees / training classes with prior approval
- Subscriptions with prior approval

Be sure to note that the following items are NOT reimbursable under this policy:

- Airline club / Country club membership dues
- Parking tickets or other fines
- Delinquency fees / Finance charges for personal credit cards
- Excess baggage charges or over weigh limit charges
- Spa charges for employees only
- Golf charges for employees only
- Expenses for travel incurred by companions/family members
- Expenses related to vacation or personal days while on a business trip
- Loss/Theft of personal funds or property/Lost baggage
- Avoidable "No-Show" charges for hotel or car service
- Non-Compulsory insurance coverage
- Rental car upgrades
- Airline seat upgrades
- Repairs due to accidents

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- Excessive mini-bar charges or alcohol charges
- Laundry and valet services (trips under 6 working days)
- Any expenditures on behalf of a terminating or transferring employee
- Purchase of clothing and other personal items such as haircuts, shoe shines, newspapers, magazines, tobacco, alcohol, etc.
- Purchase of in-room movies and entertainment

Never assume that an item will be covered under the "Miscellaneous" category. Be sure to check with your manager if an item you need is not outlined specifically in this policy.

**Entertainment Expenses: Entertaining Customers**

Entertainment expenses include events such as nightclubs, theatre and sporting events, whereby a business discussion takes place during, immediately before, or immediately after the event.

Approval for reimbursement of entertainment expenses can only be granted by department heads and will only be granted if:

- Person entertained has a potential or actual business relationship with Life Insurance Company of Alabama
- Expenditure directly precedes, includes or follows a business discussion that would benefit the company.

When entertainment expenses are expected to exceed \$200 for one event, prior approval from one of the following Life Insurance Company of Alabama employees is required to receive reimbursement:

- CEO
- CFO

**Circuitous Travel for Personal Reasons**

Business trips, which also include circuitous travel for personal reasons, will be reimbursed only for the direct or business portion of the trip, based on accommodations actually used for business purposes. Ticket stubs or traveler's receipts covering the routing of both the direct and circuitous portions of the trip must be enclosed with the expense report and the calculation of both business and personal portions of the trip should be provided

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**APPROVAL/AUTHORIZATION PROCESS**

The employee's manager must approve all expense reports. No employee is authorized to approve his/her own, a peer's, or a manager's travel expense report. The manager is responsible for verifying:

- Business purpose
- Correct totals
- Supporting documentation and receipts
- Policy compliance.

In addition, the person in attendance with the most senior title must put the expense on his/her expense report to facilitate review by a more senior person not in attendance.

Remember:

- Traveler is responsible for complying with the Life Insurance Company of Alabama's Travel & Business Expense Policy
- Manager who approves and signs the expense report is responsible for reviewing the report for compliance.

Once approval has been obtained, be sure to make a copy of the signed report along with copies of your receipts to keep for your own records.

**In Closing**

Life Insurance Company of Alabama Travel & Business Expense Policy Guidelines are designed to facilitate successful and cost effective travel. Please check with Accounting or HR regarding questions and/or feedback.

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**Appendix H - General IRS Guidelines for Travel and Entertainment**

See the website <http://www.irs.gov/publications/p463/index.html>

The below information was copied in relevant topics from that website.

When you travel away from home on business, you should keep records of all the expenses you have and any advances you receive from your employer. You can use a log, diary, notebook, or any other written record to keep track of your expenses.

**Separating costs** If you have one expense that includes the costs of meals, entertainment, and other services (such as lodging or transportation), **you must allocate that expense between the cost of meals and entertainment and the cost of other services.** You must have a reasonable basis for making this allocation. For example, you must allocate your expenses if a hotel includes one or more meals in its room charge.

**Travel Expenses You Can Deduct**

<b>IF you have expenses for...</b>	<b>THEN you can deduct the cost of...</b>
	This chart summarizes expenses you can deduct when you travel away from home for business purposes.
transportation	travel by airplane, train, bus, or car between your home and your business destination. If you were provided with a ticket or you are riding free as a result of a frequent traveler or similar program, your cost is zero. There are separate rules and limits if you travel by ship.
taxi, commuter bus, and airport limousine	fares for these and other types of transportation that take you between: The airport or station and your hotel, and The hotel and the work location of your customers or clients, your business meeting place, or your temporary work location.
baggage and shipping	sending baggage and sample or display material between your regular and temporary work locations.
car	operating and maintaining your car when traveling away from home on business. You can deduct actual expenses or the standard mileage rate, as well as business-related tolls and parking. If you rent a car while away from home on business, you can deduct only the business-use portion of the expenses.
lodging and meals	your lodging and meals if your business trip is overnight or long enough that you need to stop for sleep or rest to properly perform your duties. Meals include amounts spent for food, beverages, taxes, and related tips. See Meals for additional rules and limits.
cleaning	dry cleaning and laundry.
telephone	business calls while on your business trip. This includes business communication by fax machine or other communication devices.
tips	tips you pay for any expenses in this chart.
other	other similar ordinary and necessary expenses related to your business travel. These expenses might include transportation to or from a business meal, public stenographer's fees, computer rental fees, and operating and maintaining a house trailer.

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**How To Prove Certain Business Expenses**

**IF you have expenses for . . . THEN you must keep records that show details of the following elements . . .**

	<b>Amount</b>	<b>Time</b>	<b>Place or Description</b>	<b>Business Purpose Business Relationship</b>
<b>Travel</b>	Cost of each separate expense for travel, lodging, and meals. Incidental expenses may be totaled in reasonable categories such as taxis, fees and tips, etc.	Dates you left and returned for each trip and number of days spent on business.	Destination or area of your travel (name of city, town, or other designation).	<u>Purpose:</u> Business purpose for the expense or the business benefit gained or expected to be gained.  <u>Relationship:</u> N/A
<b>Entertainment</b>	Cost of each separate expense. Incidental expenses such as taxis, telephones, etc., may be totaled on a daily basis.	Date of entertainment	Name and address or location of place of entertainment Type of entertainment if not otherwise apparent.	<u>Purpose:</u> Business purpose for the expense or the business benefit gained or expected to be gained. For entertainment, the nature of the business discussion or activity. If the entertainment was directly before or after a business discussion: the date, place, nature, and duration of the business discussion, and the identities of the persons who took part in both the business discussion and the entertainment activity.  <u>Relationship:</u> Occupations or other information (such as names, titles, or other designations) about the recipients that shows their business relationship to you. For entertainment, you must also prove that you or your employee was present if the entertainment was a business meal.
<b>Gifts</b>	Cost of the gift.	Date of the gift.	Description of the gift.	
<b>Transportation</b>	Cost of each separate expense. For car expenses, the cost of the car and any improvements, the date you started using it for business, the mileage for each business use, and the total miles for the year.	Date of the expense. For car expenses, the date of the use of the car.	Your business destination.	<u>Purpose:</u> Business purpose for the expense.  <u>Relationship:</u> N/A

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**MEALS**

You can deduct the cost of meals in either of the following situations.

- It is necessary for you to stop for substantial sleep or rest to properly perform your duties while traveling away from home on business.
- The meal is business-related entertainment.

Business-related entertainment is discussed later. The following discussion deals only with meals that are not business-related entertainment.

**Lavish or extravagant.** You cannot deduct expenses for meals that are lavish or extravagant. An expense is not considered lavish or extravagant if it is reasonable based on the facts and circumstances. Expenses will not be disallowed merely because they are more than a fixed dollar amount or take place at deluxe restaurants, hotels, nightclubs, or resorts.

**50% limit on meals.** You can figure your meals expense using either of the following methods.

- Actual cost.
- The standard meal allowance.

Both of these methods are explained below. But, regardless of the method you use, you generally can deduct only 50% of the unreimbursed cost of your meals.

**Actual Cost**

You can use the actual cost of your meals to figure the amount of your expense before reimbursement and application of the 50% deduction limit. If you use this method, you must keep records of your actual cost.

**Standard Meal Allowance**

Generally, you can use the “standard meal allowance” method as an alternative to the actual cost method. It allows you to use a set amount for your daily meals and incidental expenses (M&IE), instead of keeping records of your actual costs. The set amount varies depending on where and when you travel. “Standard meal allowance” refers to the federal rate for M&IE. If you use the standard meal allowance, you still must keep records to prove the time, place, and business purpose of your travel.

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**Incidental expenses.** The term “incidental expenses” means:

- Fees and tips given to porters, baggage carriers, bellhops, hotel maids, stewards or stewardesses and others on ships, and hotel servants in foreign countries,
- Transportation between places of lodging or business and places where meals are taken, if suitable meals can be obtained at the temporary duty site, and
- Mailing costs associated with filing travel vouchers and payment of employer-sponsored charge card billings.

Incidental expenses do not include expenses for laundry, cleaning and pressing of clothing, lodging taxes, or the costs of telegrams or telephone calls.

**Incidental expenses only method.** You can use an optional method (instead of actual cost) for deducting incidental expenses only. The amount of the deduction is \$5 a day. You can use this method only if you did not pay or incur any meal expenses. You cannot use this method on any day that you use the standard meal allowance. This method is subject to the proration rules for partial days..

**Note.**

The incidental expenses only method is not subject to the 50% limit discussed below.

**ENTERTAINMENT**

You may be able to deduct business-related entertainment expenses you have for entertaining a client, customer, or employee.

You can deduct entertainment expenses only if they are both ordinary and necessary and meet one of the following tests.

- Directly-related test.
- Associated test.

An ordinary expense is one that is common and accepted in your trade or business. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be required to be considered necessary.

The amount you can deduct for entertainment expenses may be limited. Generally, you can deduct only 50% of your unreimbursed entertainment expenses.

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**Directly-Related Test**

To meet the directly-related test for entertainment expenses (including entertainment-related meals), you must show that:

- The main purpose of the combined business and entertainment was the active conduct of business,
- You did engage in business with the person during the entertainment period, and
- You had more than a general expectation of getting income or some other specific business benefit at some future time.

Business is generally not considered to be the main purpose when business and entertainment are combined on hunting or fishing trips, or on yachts or other pleasure boats. Even if you show that business was the main purpose, you generally cannot deduct the expenses for the use of an entertainment facility.

You must consider all the facts, including the nature of the business transacted and the reasons for conducting business during the entertainment. It is not necessary to devote more time to business than to entertainment. However, if the business discussion is only incidental to the entertainment, the entertainment expenses do not meet the directly-related test.

**When Are Entertainment Expenses Deductible?**

General rule	You can deduct ordinary and necessary expenses to entertain a client, customer, or employee if the expenses meet the directly-related test or the associated test.
Definitions	<ul style="list-style-type: none"> <li>• Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation, and includes meals provided to a customer or client.</li> <li>• An ordinary expense is one that is common and accepted in your trade or business.</li> <li>• A necessary expense is one that is helpful and appropriate.</li> </ul>
Tests to be met	<p>Directly-related test</p> <ul style="list-style-type: none"> <li>• Entertainment took place in a clear business setting, or</li> <li>• Main purpose of entertainment was the active conduct of business, and You did engage in business with the person during the entertainment period, and You had more than a general expectation of getting income or some other specific business benefit.</li> </ul>
	<p>Associated test</p> <ul style="list-style-type: none"> <li>• Entertainment is associated with your trade or business, and</li> <li>• Entertainment is directly before or after a substantial business discussion.</li> </ul>
Other rules	<ul style="list-style-type: none"> <li>• You cannot deduct the cost of your meal as an entertainment expense if you are claiming the meal as a travel expense.</li> <li>• You cannot deduct expenses that are lavish or extravagant under the circumstances.</li> <li>• You generally can deduct only 50% of your unreimbursed entertainment expenses</li> </ul>

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You do not have to show that business income or other business benefit actually resulted from each entertainment expense.

**Clear business setting.** If the entertainment takes place in a clear business setting and is for your business or work, the expenses are considered directly related to your business or work. The following situations are examples of entertainment in a clear business setting.

- Entertainment in a hospitality room at a convention where business goodwill is created through the display or discussion of business products.
- Entertainment that is mainly a price rebate on the sale of your products (such as a restaurant owner providing an occasional free meal to a loyal customer).
- Entertainment of a clear business nature occurring under circumstances where there is no meaningful personal or social relationship between you and the persons entertained. An example is entertainment of business and civic leaders at the opening of a new hotel or play when the purpose is to get business publicity rather than to create or maintain the goodwill of the persons entertained.

**Expenses not considered directly related.** Entertainment expenses generally are not considered directly related if you are not there or in situations where there are substantial distractions that generally prevent you from actively conducting business. The following are examples of situations where there are substantial distractions.

- A meeting or discussion at a nightclub, theater, or sporting event.
- A meeting or discussion during what is essentially a social gathering, such as a cocktail party.
- A meeting with a group that includes persons who are not business associates at places such as cocktail lounges, country clubs, golf clubs, athletic clubs, or vacation resorts.

**Associated Test**

Even if your expenses do not meet the directly-related test, they may meet the associated test.

To meet the associated test for entertainment expenses (including entertainment-related meals), you must show that the entertainment is:

- Associated with the active conduct of your trade or business, and
- Directly before or after a substantial business discussion (defined later).

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**Associated with trade or business.** Generally, an expense is associated with the active conduct of your trade or business if you can show that you had a clear business purpose for having the expense. The purpose may be to get new business or to encourage the continuation of an existing business relationship.

**Substantial business discussion.** Whether a business discussion is substantial depends on the facts of each case. A business discussion will not be considered substantial unless you can show that you actively engaged in the discussion, meeting, negotiation, or other business transaction to get income or some other specific business benefit.

The meeting does not have to be for any specified length of time, but you must show that the business discussion was substantial in relation to the meal or entertainment. It is not necessary that you devote more time to business than to entertainment. You do not have to discuss business during the meal or entertainment.

***Meetings at conventions.*** You are considered to have a substantial business discussion if you attend meetings at a convention or similar event, or at a trade or business meeting sponsored and conducted by a business or professional organization. However, your reason for attending the convention or meeting must be to further your trade or business. The organization that sponsors the convention or meeting must schedule a program of business activities that is the main activity of the convention or meeting.

**Directly before or after business discussion.** If the entertainment is held on the same day as the business discussion, it is considered to be held directly before or after the business discussion.

If the entertainment and the business discussion are not held on the same day, you must consider the facts of each case to see if the associated test is met. Among the facts to consider are the place, date, and duration of the business discussion. If you or your business associates are from out of town, you must also consider the dates of arrival and departure, and the reasons the entertainment and the discussion did not take place on the same day.

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**50% Limit**

In general, you can deduct only 50% of your business-related meal and entertainment expenses.

The 50% limit applies to employees or their employers, and to self-employed persons (including independent contractors) or their clients, depending on whether the expenses are reimbursed.

The 50% limit applies to business meals or entertainment expenses you have while:

- Traveling away from home (whether eating alone or with others) on business,
- Entertaining customers at your place of business, a restaurant, or other location, or
- Attending a business convention or reception, business meeting, or business luncheon at a club.

**Included expenses.** Expenses subject to the 50% limit include:

- Taxes and tips relating to a business meal or entertainment activity,
- Cover charges for admission to a nightclub,
- Rent paid for a room in which you hold a dinner or cocktail party, and
- Amounts paid for parking at a sports arena.

However, the cost of transportation to and from a business meal or a business-related entertainment activity is not subject to the 50% limit.

**Lavish or extravagant expenses.** You cannot deduct expenses for entertainment that are lavish or extravagant. An expense is not considered lavish or extravagant if it is reasonable considering the facts and circumstances. Expenses will not be disallowed just because they are more than a fixed dollar amount or take place at deluxe restaurants, hotels, nightclubs, or resorts.

**Allocating between business and nonbusiness.** If you entertain business and nonbusiness individuals at the same event, you must divide your entertainment expenses between business and nonbusiness. You can deduct only the business part. If you cannot establish the part of the expense for each person participating, allocate the expense to each participant on a pro rata basis.

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**What Entertainment Expenses Are Not Deductible?**

This section explains different types of entertainment expenses you generally may not be able to deduct.

**Club dues and membership fees.** You cannot deduct dues (including initiation fees) for membership in any club organized for:

- Business,
- Pleasure,
- Recreation, or
- Other social purpose.

This rule applies to any membership organization if one of its principal purposes is either:

- To conduct entertainment activities for members or their guests, or
- To provide members or their guests with access to entertainment facilities, discussed later.

The purposes and activities of a club, not its name, will determine whether or not you can deduct the dues. You cannot deduct dues paid to:

- Country clubs,
- Golf and athletic clubs,
- Airline clubs,
- Hotel clubs, and
- Clubs operated to provide meals under circumstances generally considered to be conducive to business discussions.

**Entertainment facilities.** Generally, you cannot deduct any expense for the use of an entertainment facility. This includes expenses for depreciation and operating costs such as rent, utilities, maintenance, and protection.

An entertainment facility is any property you own, rent, or use for entertainment. Examples include a yacht, hunting lodge, fishing camp, swimming pool, tennis court, bowling alley, car, airplane, apartment, hotel suite, or home in a vacation resort.

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**TRANSPORTATION**

These expenses include the cost of transportation by air, rail, bus, taxi, etc., and the cost of driving and maintaining your car.

Transportation expenses include the ordinary and necessary costs of all of the following.

- Getting from one workplace to another in the course of your business or profession when you are traveling within the city or general area that is your tax home.
- Visiting clients or customers.
- Going to a business meeting away from your regular workplace.
- Getting from your home to a temporary workplace when you have one or more regular places of work. These temporary workplaces can be either within the area of your tax home or outside that area.

Transportation expenses do not include expenses you have while traveling away from home overnight. However, if you use your car while traveling away from home overnight, use the rules in this chapter to figure your car expense deduction. See *Car Expenses*.

Daily transportation expenses you incur while traveling from home to one or more regular places of business are generally nondeductible commuting expenses. However, there may be exceptions to this general rule. You can deduct daily transportation expenses incurred going between your residence and a temporary work station outside the metropolitan area where you live. Also, daily transportation expenses can be deducted if: (1) If you have one or more regular work locations away from your residence or (2) your residence is your principal place of business and you incur expenses going between the residence and another work location in the same trade or business, regardless of whether the work is temporary or permanent and regardless of the distance.

**Car Expenses**

If you use your car for business purposes, you ordinarily can deduct car expenses. You generally can use one of the two following methods to figure your deductible expenses.

- Standard mileage rate.
- Actual car expenses.

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***Standard Mileage Rate***

You may be able to use the standard mileage rate to figure the deductible costs of operating your car for business purposes. After June 30, 2011, the business mileage rate increases to 55½ cents per mile.

If you use the standard mileage rate for a year, you cannot deduct your actual car expenses for that year. You cannot deduct depreciation, lease payments, maintenance and repairs, gasoline (including gasoline taxes), oil, insurance, or vehicle registration fees.

***Actual Car Expenses***

If you do not use the standard mileage rate, you may be able to deduct your actual car expenses.

If you qualify to use both methods, you may want to figure your deduction both ways to see which gives you a larger deduction.

Actual car expenses include:

Depreciation	Lease	Registration
Licenses	payments	fees
Gas	Insurance	Repairs
Oil	Garage rent	Tires
Tolls	Parking fees	

If you have fully depreciated a car that you still use in your business, you can continue to claim your other actual car expenses.

**Business and personal use.** If you use your car for both business and personal purposes, you must divide your expenses between business and personal use. You can divide your expense based on the miles driven for each purpose.