

**LIFE INSURANCE COMPANY
OF ALABAMA**

INTERNAL AUDIT REPORT
AS OF DECEMBER 31, 2014



WILLIS BOATNER PUGH
CERTIFIED PUBLIC ACCOUNTANTS

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

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

Listed below are the internal audit recommendations that were examined in the months of July 2014 through December 2014. 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	Observations by Risk		
	High	Medium	Low
1. Fixed assets			X
2. Accounts payable		X	
3. Cash receipts		X	
4. Investments		X	
5. Benford's Law testing	X		
6. Company name and agent search		X	
7. Company website search		X	
8. New policies or changes to policy testing		X	
9. Travel and entertainment	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
Life Insurance Company of Alabama**

**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 third and fourth quarters of 2014 as they related to fixed assets or repairs and maintenance and verified they were in compliance with the Company's policy. Evaluate 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 the 2014 property tax return for accuracy and completeness.

Key Highlights:

- For the third and fourth quarter of 2014 expenditures described above, no observations were noted.
- For the verification of the subsidiary ledger to the fixed asset schedule for the third and fourth quarter, no observations were noted.
- For the review of the 2014 property tax return, no observations were noted.

Suggestions for Improvement or Observations Noted:

- During the third and fourth quarters of 2014 testing, we noted no additional suggestions for improvements or observations.

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

**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 last six months of the 2014 year and sorted the detail by check type. Randomly selected 30 checks from each type of disbursement: general accounts payable expenses, LSP and HCP expenses to test for proper key control compliance.
- From the sample selected, each significant control area for general 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.
 - Check amount posted to the general ledger agreed to the electronic system scanned file.
- From the sample selected, each significant control area for LSP disbursements was tested for proper compliance with the policy. Controls tested were as follows:
 - Approval of payment was noted.
 - 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.
 - Check amount posted to the general ledger agreed to the electronic system scanned file.

Internal Audit Report
Life Insurance Company of Alabama

Internal Audit Summary Report
Accounts Payable - Continued

- From the sample selected, each significant control area for HCP disbursements was tested for proper compliance with the policy. Controls tested were as follows:
 - Check copy was located in the electronic system.
 - Documentation was in the electronic policy folder stating why there was a reimbursement and medical reports, if necessary, were included.
 - Payment was approved and agreed to policy application.

Key Highlights:

- For the sample of general expenditures, LSP expenditures and HCP expenditures selected for the last six months of the 2014 year, no observations were noted.

Suggestions for Improvement or Observations Noted:

- During the last six months of the 2014 year testing, we noted no additional suggestions for improvements or observations.

Suggestions for Improvement or Observations Noted in Previous reports:

- During the third and fourth quarters of 2014 testing, we noted no additional suggestions for improvements or observations. Our previous suggestions have been addressed.

**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 receipt 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 2014 year. Randomly selected 60 receipts to test for proper key control compliance. The sample included both ACH and check deposits.
- From the sample 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 amounts were traced to clearing the bank statement.
 - For deposits that were only checks, checks were footed to the deposit total.
- Reviewed four months bank reconciliations for proper reconciliation and review.
- One day's deposit detail was received each six months that listed each policy holders account number and amount paid. This detail was footed and agreed back to the deposited amount. Each policy holder's payment was traced to being properly applied to their account balance in the general ledger system.

Key Highlights:

- For the sample of cash receipts selected for the 2014 year, no observations were noted.
- During the review of the bank reconciliations there were no observations noted.
- During the testing of one day's deposit detail there were no observations noted.

Suggestions for Improvement or Observations Noted:

- During the 2014 year testing, we noted no additional suggestions for improvements or observations.

Suggestions for Improvement or Observations Noted in Previous reports:

- LICOA is currently working on cash receipt suggestions noted in our previous report related to policies and procedures.

**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 from July 2014 to December 2014 and suggested any journal entries as necessary.
- Agreed common stock and bond amounts per the brokerage statements to schedule D for the year ended December 2014.
- Analyze the bond holdings for any write downs based on a NAIC rating of 5FE 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:

- There were no significant differences between the investment statements and the posting in the general ledger for the period from July 2014 until December 2014. Any monthly differences were timing differences that cleared the next month.
- 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 review of the NAIC ratings of 5FE or below, we noted no additional suggestions for improvements or observations.

Suggestions for Improvement or Observations Noted:

- During the last six months of the 2014 year testing, we noted no additional suggestions for improvements or observations.

Suggestions for Improvement or Observations Noted in Previous reports:

- LICOA is currently working on investment suggestions noted in our previous report related to policies and procedures.

**Internal Audit Report
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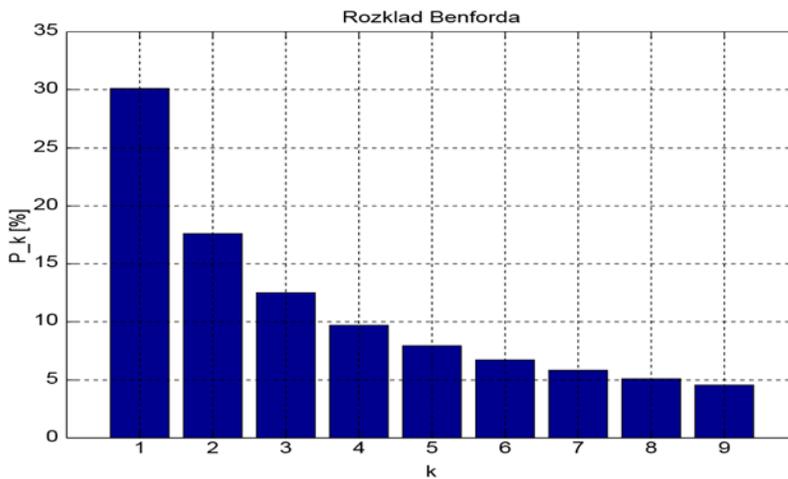
**Internal Audit Summary Report
Benford's Law Testing**

Observations by Risk		
H	M	L
X		

Benford's Law - Definition, History and Application

What is Benford's Law?

Benford's Law, named for physicist Frank Benford, is the mathematical theory of leading digits. Specifically, in data sets, the leading digit(s) is (are) distributed in a specific, nonuniform way. While one might think that the number 1 would appear as the first digit 11 percent of the time (i.e., one of nine possible numbers), it actually appears about 30 percent of the time (see chart below). Nine, on the other hand, is the first digit less than 5 percent of the time. The theory covers the first digit, second digit, first two digits, last digit and other combinations of digits because the theory is based on a logarithm of probability of occurrence of digits.



Accounting fraud detection

In 1972, Hal Varian suggested that the law could be used to detect possible fraud in lists of socio-economic data submitted in support of public planning decisions. Based on the plausible assumption that people who make up figures tend to distribute their digits fairly uniformly, a simple comparison of first-digit frequency distribution from the data with the expected distribution according to Benford's Law ought to show up any anomalous results. Following this idea, Mark Nigrini showed that Benford's Law could be used in forensic accounting and auditing as an indicator of accounting and expenses fraud.

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

**Internal Audit Summary Report
Benford's Law Testing - Continued**

Distributions that can be expected to obey Benford's Law

- Credit card transactions
- Purchase orders
- Loan data
- Customer balances
- Journal entries
- Stock prices
- Accounts payable transactions
- Inventory prices
- Customer refunds

Distributions that would not be expected to obey Benford's Law

- Where numbers are assigned: e.g., check numbers, invoice numbers
- Where numbers are influenced by human thought: e.g., prices set by psychological thresholds (\$1.99)
- Accounts with a large number of firm-specific numbers: e.g., accounts set up to record \$100 refunds
- Accounts with a built-in minimum or maximum
- Where no transaction is recorded
- Data sets with 500 or fewer transactions

Conclusion

Benford's Law can recognize the probabilities of highly likely or highly unlikely frequencies of numbers in a data set. The probabilities are based on mathematical logarithms of the occurrence of digits in randomly generated numbers in large data sets. Those who are not aware of this theory and intentionally manipulate numbers (e.g., in a fraud) are susceptible to getting caught by the application of Benford's Law.

Scope and Approach:

Taking into consideration the disbursements that would not be expected to obey Benford's Law our evaluation included the following procedures related to general accounts payable:

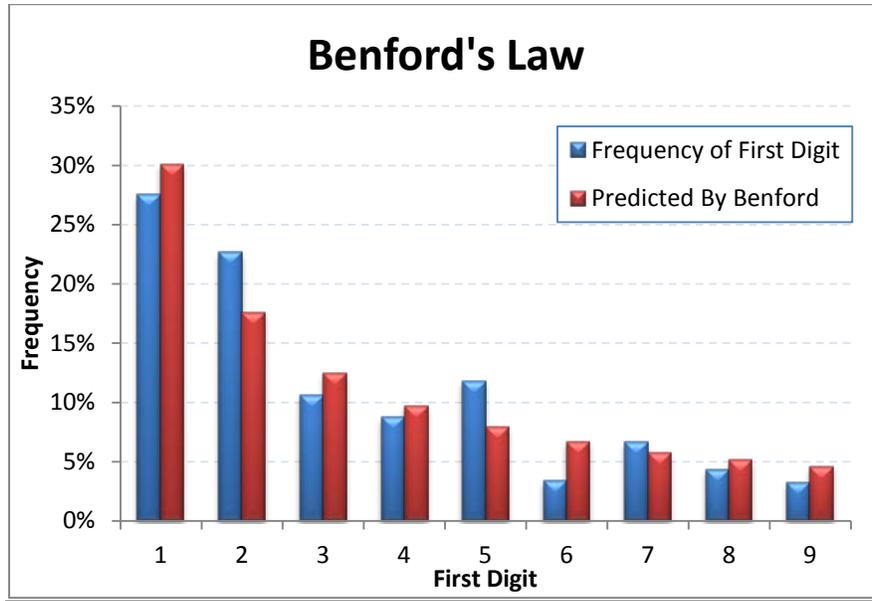
- Received a listing of all general accounts payable checks written for the period of January 2014 until December 2014.
- Imported into a Benford's Law spreadsheets the check amount, see results below.

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

**Internal Audit Summary Report
Benford's Law Testing - Continued**

Key Highlights:

General Accounts Payable Checks Written from January to December 2014



First Digit	Occurrence Of Digit	Frequency of First Digit at 12/31/14	Frequency of First Digit at 6/30/14	Predicted By Benford
One	324	27.53%	28.67%	30.10%
Two	267	22.68%	21.49%	17.61%
Three	125	10.62%	11.10%	12.49%
Four	103	8.75%	7.19%	9.69%
Five	139	11.81%	10.94%	7.92%
Six	40	3.40%	6.15%	6.69%
Seven	78	6.63%	5.51%	5.80%
Eight	51	4.33%	4.15%	5.12%
Nine	38	3.23%	4.79%	4.58%

Suggestions for Improvement or Observations Noted:

- There were no large unexpected deviations noted during this test.

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

**Internal Audit Summary Report
Company Name and Agent Search**

Observations by Risk		
H	M	L
	X	

Background:

This test was included as an internal audit step to research no individual or company has filed for a name similar to Life Insurance Company of Alabama.

Key Highlights:

- Life Insurance Company of Alabama was registered in the following states:
 - Alabama - Lynn Lowe listed as the registered agent
 - Georgia - Samuel Pierce, Jr. listed as registered agent
 - Tennessee - No agent listed, dissolved; inactive
 - Arkansas - No agent listed
 - Florida - Steven Keck and Lynn Lowe listed as officers, Clarence Dauge, III listed as CEO
- Life Insurance Co. of AI was registered in the following state:
 - Alabama - J S Holleman listed as the incorporator.
- Alabama Life Insurance Company was registered in the following state:
 - Alabama - A L Welch listed as the registered agent, dissolved 2001
- LICOA Brokerage Services, Inc. was registered in the following state:
 - Alabama - Raymond Renfrow, Jr. listed as the registered agent.
- LICOA Employee Benefits, Inc.
 - Mississippi - Lewis W. West, III listed as the registered agent
- LICOA, Inc.
 - Oklahoma - Kent Frates listed as the agent
- LICOA National, Inc.
 - Kentucky - Robt H. Davis listed as the incorporator

Suggestions for Improvement or Observations Noted:

- The audit committee or board should review the above list and determine if any additional inquires need to be made.

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

**Internal Audit Summary Report
Company Website Search**

Observations by Risk		
H	M	L
	X	

Background:

This test was included as an internal audit step to research the domain name LICOA.com.

Key Highlights:

- The following was found during the search for the name LICOA.com:
 - Registrar: Wild West Domains, LLC
 - Registrant Name: Jeff Casey
 - Server: whois.wildwestdomains.com
 - Registrant Organization: Life Insurance Company of Alabama
 - Registrant Email: jcasey@licoa.com
 - Admin: Jeff Casey
 - Admin Organization: Life Insurance Company of Alabama
 - Tech Organization: Life Insurance Company of Alabama
 - Tech email: jcasey@licoa.com
 - Expiration date: July 22, 2015
 - On the website www.scamadvisor.com Jeff Casey is listed as owner of the website

- Extensible Provisioning Protocol (EPP) domain status codes, indicate the status of a domain name registration. A particular domain may have more than one status code, but must have at least one. The status codes for the Company's domain, which were set by the domain's registrar are as follows:
 - clientTransferProhibited - This status code tells your domain's registry to reject requests to transfer the domain from your current registrar to another. If you do want to transfer your domain, you must first contact your registrar and request that they remove this status.
 - clientUpdateProhibited - This status code tells your domain's registry to reject requests to update the domain
 - client RenewProhibited - This status code tells your domain's registry to reject requests to renew your domain. It is an uncommon status that is usually enacted during legal disputes or when your domain is subject to deletion.
 - clientDeleteProhibited - This status code tells your domain's registry to reject requests to delete the domain, name registration, which can prevent unauthorized deletions resulting from hijacking and/or fraud.

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

**Internal Audit Summary Report
Company Website Search (Continued)**

Observations by Risk		
H	M	L
	X	

Suggestions for Improvement or Observations Noted:

- There is no segregation of duties regarding the domain name. The owner of the website is an employee of the Company, not the Company or shareholder.
- The audit committee or board should review the above list and determine if changes need to be made.
- Note the expiration period is July, 2015.

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

**Internal Audit Summary Report
New Policies or Changes to Policies Testing**

Observations by Risk		
H	M	L
	X	

Background:

This test was an assessment of the internal controls related to new or changed insurance policies. It was included in the internal audit plan due to the importance of proper documentation and set up of insurance policies.

Scope and Approach:

Our evaluation included the following procedures related to new or changes to insurance policies of the Company:

- Developed an understanding of the processes and controls in place for insurance policies.
- Understand the different types of policies and changes
- Randomly select one month to test new or changes to policies.

Key Highlights:

- Randomly selected the month of October 2014 to test certain insurance policies. The following types and number of policies were tested for the month of October 2014.
 - Policies issued and paid - 30 policies tested
 - Application was included in the file
 - Any changes in the policy between completing the application and the policy becoming effective was in the file, if necessary.
 - The face amount of life insurance policies agreed between the application and what was recorded.
 - Commission was properly set up for the agent(s).
 - Medical records or other types of verification was included in the file, if necessary.

Suggestions for Improvement or Observations Noted:

- During the month of October 2014, we noted no additional suggestions for improvements or observations. There were no exceptions noted during our testing.

**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 year ended 2014. 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 (Continued)**

Key Highlights:

- There were meal expenses without detailed receipts. Per Company policy, detailed receipts are required for all meal and entertainment expenses in excess of \$25.00.
- The Company should consider giving a more clear description of excessive alcohol charges, or consider changing company policy. The policy states to limit the consumption of alcoholic beverages during business functions, but excessive consumption is not clear.
- There were a few instances in which Company entertainment expenses were only Company Executives, which is contrary to Company policy which states that approval for reimbursement of entertainment expenses can only be granted if the person entertained has a potential or actual business relationship with Life Insurance Company of Alabama.

Suggestions for Improvement or Observations Noted:

- Evaluate the threshold of required detailed receipts for meals and action when a detailed receipt is not presented.
- There needs to be a discussion of what is considered appropriate or excess for reimbursing alcoholic charges.
- Entertainment expenses should follow the IRS guidelines for proper business expense; otherwise they need to be reimbursed by the employee.
- From the previous testing of this policy, there have been significant improvements.