

**LIFE INSURANCE COMPANY
OF ALABAMA**

INTERNAL AUDIT REPORT
AS OF MAY 31, 2013



WILLISBOATNER&WHITESIDELLC
certified public accountants

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**Internal Audit Report
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Listed below are the internal audit recommendations that were examined in the months of October 2012, November 2012 and December 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	Observations by Risk		
	High	Medium	Low
1. Fixed assets			X
2. Accounts payable		X	
3. Cash receipts		X	
4. Investments		X	
5. Payroll		X	
6. Internal policy and procedure testing		X	
7. Policyholders' complaints			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 2012 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 all lease agreements currently outstanding for proper treatment as an operating lease or a capital lease.

Key Highlights:

- For the third and fourth quarter of 2012 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 current lease agreements outstanding for proper treatment, no observations were noted.

Suggestions for Improvement or Observations Noted:

- During the third and fourth quarters of 2012 testing, we noted no additional suggestions for improvements or observations.

Suggestions for Improvement or Observations Noted in Previous Report:

- Life Insurance of Alabama has modified their accounting policy for fixed assets to incorporate our previous suggestions related to including accounting procedures in the policy, having a value of fixed asset purchases or repairs to be approved by the board and a prepaid expense threshold for capitalization.

**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 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 and general expenditures selected for the last six months of the 2012 year, no observations were noted.

Suggestions for Improvement or Observations Noted:

- During the last six months of the 2012 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 accounts payable suggestions noted in our previous report related to policies and procedures.

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**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 last 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:

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

Suggestions for Improvement or Observations Noted:

- During the last six months of the 2012 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:

- Agreed each month's postings from the brokerage statement activity to the general ledger from July 2012 until December 2012 and suggested any journal entries.
- Agreed common stock and bond amounts per the brokerage statements to schedule D for the year ended December 2012.

Key Highlights:

- There were no significant differences between the investment statements and the posting in the general ledger for the period from July 2012 until December 2012. Any monthly differences were timing differences that cleared the next month.

Suggestions for Improvement or Observations Noted:

- During the last six months of the 2012 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
Payroll**

Observations by Risk		
H	M	L
	X	

Background:

This test was an assessment of the internal controls related to payroll. It was included in the internal audit plan due to the importance of having proper payroll policies and procedures. This is an area that can be subject to external audits from federal, state or local agencies.

Scope and Approach:

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

- Developed an understanding of the processes and controls in place for payroll.
- Received a list of all employees employed as of August 2012 and selected 30 employees for testing.
- The following items were tested in the employee files for the 30 employees selected:
 - Salary was approved in the employee file or minutes
 - Employee evaluations were in the file, if required
 - An I-9 form was completed if the employee was hired after the date this form was required
 - A copy of the employees drivers license was in the file, if required
 - A copy of the employee's social security card was in the file, if required
 - A signed confidentiality agreement was in the file, if required
 - An application was in the file, if required
 - E-verify was completed if the employee was hired after the requirement date
 - A new hire form was completed if hired after the requirement date
 - A form A-4 and W-4 was completed
- The following items were tested for the month of August 2012 payroll for the 30 employees selected:
 - The gross amount paid agreed to the approved payroll amount in the employee file
 - A time sheet was completed, signed by the employee, approved and hours agreed to the gross amount paid, if required
 - Any stick time or vacation time included in the payroll was approved
 - The total amount paid for the month of August agreed to the amount posted in the general ledger for August
- The following tax returns were examined and recalculated:
 - Alabama withholding for August 2012
 - 3rd quarter FUTA
 - 3rd quarter SUTA
 - August FICA payments
 - 3rd quarter 941
 - Gadsden occupational taxes for August

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**Internal Audit Summary Report
Payroll - Continued**

Scope and Approach - Continued:

- The total amount paid, net of withholdings, in August was traced to the August bank statements as properly clearing the bank account.
- For the payroll dated August 29, 2012, the following items were recalculated for the 30 employees selected:
 - FICA
 - City of Gadsden withholding
 - 401(k) withholding amount

Key Highlights:

- There was one employee that did not have a new hire form completed that was required to have one completed. There were no other exceptions noted during the testing of the employee files.
- There were no exceptions noted while testing the month of August 2012 payroll.
- There were no exceptions noted while recalculating the tax returns examined.
- There were no exceptions noted while agreeing the net amount paid for August to the bank statements.
- There were no exceptions noted during the recalculation of the FICA amounts withheld. During the recalculation of the City of Gadsden withholding of there were four employees that were not paying the full 2% withholding for city taxes. Per further inquiry, there is currently no documentation as to why these employees are not paying the full amount required. During the recalculation of the 401(k) withholding amounts, there were two employees that did not have signed 401(k) withholding forms from the Hartford

Suggestions for Improvement or Observations Noted:.

- Although all required forms were given to us during the above testing, it was noted that some forms were located in different folders and boxes and not with the employee's file. We would suggest that all forms that relate to an employee's payroll processing be located in one employee folder. A-4 and W-4 forms were located in boxes in no specific order and 401(k) withholding forms were located in several different folders in no specific order.
- There is no formal policies and procedures related to payroll, see Appendix A for a guide to creating a policy.
- There was no written documentation as to why certain employees are not paying the full 2% of the City of Gadsden withholding tax. This documentation must be in writing and adhere to the requirements set by the City.

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

**Internal Audit Summary Report
Payroll - Continued**

Suggestions for Improvement or Observations Noted - Continued:

- Per the insurance examination report there was a recommendation that the Company adopt an internal policy for determining, by means of background checks or investigation or otherwise, that those with whom the Company does business meet the requirement of Section 1033 as required by ALA Admin Code 482-1-146.11. We did not note that a policy has been implemented for this recommendation.

**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 B for a suggested record retention policy.

Suggestions for Improvement or Observations Noted in Previous reports:

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

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

**Internal Audit Summary Report
Policyholders' Complaints**

Observations by Risk		
H	M	L
		X

Background:

This procedure was tested as a direct response to the insurance examiner's report. In that report it stated the following: "Recommendation that the Company respond to all complaints (consumer direct and ADLOI) within 10 days in accordance with the requirements of Ala. Admin Code 482-1-118.6 (1999).

Scope and Approach:

Our evaluation included the following procedures related to written policyholders' complaints of the Company:

- Received the written complaint claim log from 2009 until December 2012.
- Tested the five most recent complaints as being properly resolved within the required time frame.
- Tested 5 additional claims, making sure at least one complaint in each year of the report was tested.
- Reviewed the claims still showing as pending on the report and verified the claim was closed by a later claim letter or response.

Suggestions for Improvement or Observations Noted:

- There were no exceptions noted during this testing.

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

Summary of Suggestions for Improvements

Fixed Assets

- During the third and fourth quarter of 2012 testing, we noted no additional suggestions for improvements or observations

Accounts Payable

- During the last six months of the 2012 year testing, we noted no additional suggestions for improvements or observations.

Cash Receipts

- During the last six months of the 2012 year testing, we noted no additional suggestions for improvements or observations.

Investments

- There were no significant differences between the investment statements and the posting in the general ledger for the period from July 2012 until December 2012. Any monthly differences were timing differences that cleared the next month.

Payroll

- We would suggest that all forms that relate to an employee's payroll be located in one employee folder. A-4 and W-4 forms were located in boxes in no specific order and 401(k) withholding forms were located in several different folders in no specific order.
- There is no formal policies and procedures related to payroll, see Appendix A for a guide to creating a policy.
- There was no written documentation as to why certain employees are not paying the full 2% of the City of Gadsden withholding tax. This documentation must be in writing and adhere to the requirements set by the City.
- Per the insurance examination report there was a recommendation that the Company adopt an internal policy for determining, by means of background checks or investigation or otherwise, that those with whom the Company does business meet the requirement of Section 1033 as required by ALA Admin Code 482-1-146.11. We did not note that a policy has been implemented for this recommendation.

Internal Policies and Procedures

- See Appendix B for a suggested record retention policy.

Policyholders' Complaints

- No exceptions or suggestions noted.

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

APPENDIX A - EXAMPLE PAYROLL POLICIES AND PROCEDURES

Key elements of a policies and procedures manual for payroll should address the following items:

- All wages are properly authorized and approved
- All wage computations are accurate and properly recorded in the accounts
- Proper segregation of duties

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

Separation of incompatible duties and restricted access

1. Are persons preparing payroll independent of other payroll and personnel duties (e.g. timekeeping, distribution of checks and hiring employees) and restricted from access to other payroll data or cash?
2. Are responsibilities for payroll accounting separate from the general ledger function?
3. Is there restricted access to:
 - a. Blank payroll checks (if applicable)
 - b. Personnel records?
4. Are employees with payroll responsibilities required to take vacations, and are other employees required to perform those functions when an employee is absent?
5. Is access to computerized payroll records limited to those with a logical need for such access?

Recording

1. Are prenumbered payroll checks used, the sequence accounted for and unissued checks controlled (is applicable)?
2. Reconciliations and review:
 - a. Are the payroll registers and the general ledger reconciled to gross and net pay amounts per the payroll tax returns?
 - b. Is there a year end reconciliation of total W-2 wages (including taxable fringe benefits) to the general ledger and payroll register wages paid?
 - c. Is there a periodic general review of payroll registers by the owner/manager or other appropriate person?
 - d. Are totals of payroll registers footed and agreed to amounts recorded in the general ledger?
 - e. Does the owner/manager or other appropriate person review reconciliations between payroll registers and general ledger control accounts?
 - f. Does the owner/manager or other appropriate person periodically compare actual to budgeted payroll and investigate and document significant variances?
 - g. Are detail records maintained of the liability for compensated absences and are they regularly reconciled to the control account?

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APPENDIX A - EXAMPLE PAYROLL POLICY AND PROCEDURES - Continued

3. Other checking or processing routines:
 - a. Are their adequate authorization, approval and documentation procedures regarding changes in employment (additions and terminations); in salary and wage rates; and in amounts of payroll deductions?
 - b. Are there adequate authorization and approval procedures regarding vacation, holiday and sick leave compensation?
 - c. Are notices of changes in personnel data reported promptly to the payroll accounting function and recorded promptly in a payroll database?
 - d. Are there adequate timekeeping and attendance records and procedures (e.g. time cards and time clocks are properly controlled and approved)?
 - e. Does the owner/manager or other appropriate person compare current payrolls with previous payrolls and investigate and document significant variances?
 - f. Before disbursement, are payroll transactions reviewed and approved to ensure that:
 - i. Payroll transactions are for authorized employees?
 - ii. Payroll transactions are supported by time records?
 - iii. Authorized pay rates are used?
 - iv. Gross pay, deductions and net pay are accurate?
 - v. Paychecks agree with payroll registers?
 - g. Are deposits to the payroll bank account compared with the payroll register?
 - h. Is payment of wages in cash prohibited, except in prescribed circumstances?
 - i. Are unclaimed payroll checks properly controlled initially (i.e. listing of checks) at the time of their subsequent distribution (i.e. evidence of employment and other identification required and signatures obtained)?
 - j. Are procedures in place to ensure that payroll taxes are paid in a timely manner and that payroll tax returns are filed when due?
 - k. Are procedures in place to ensure that other withholdings, such as 401(k) and cafeteria plan withholdings, are remitted in a timely manner?
 - l. Are there procedures for preparing, mailing and investigating subsequently returned W-2s and related forms?
 - m. Are procedures in place to ensure year end W-2 forms are prepared accurately and that all taxable fringe benefits are included?
 - n. Are personal files checks to determine that withholding forms and authorizations for payroll deductions exist?
 - o. Are monthly payroll-related accruals reviewed for completeness and reasonableness by the owner/manager or other appropriate person?
 - p. Are employee benefit matters monitored by individuals who are knowledgeable of the applicable legal, regulatory, actuarially and accounting requirements?
 - q. Are sales commissions reconciled with sales records?

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APPENDIX B - EXAMPLE RECORD RETENTION POLICY

Companies can build up a substantial collection of records over their years in operation. While nobody wants to be stuck holding onto documents that have outlived their usefulness, throwing away a document only to find out later that you need it can be a costly mistake.

Records Retention Program

The simplest way for a company to manage all the records it acquires is to institute a records retention program that defines how long documents are to be kept. The program should specifically define the different types of records your company works with and how each should be treated. Creating a standard will help ensure that the documents you need will be there when the time comes and that any unnecessary clutter will be kept to a minimum.

Retain Based on Policy Types

Given all the different elements involved with running a business, your company has likely carried and written a variety of insurance coverage over its lifetime. Since each may come into play differently in the future, the type of plan you're dealing with is crucial when figuring out what should be saved and what can be tossed.

Occurrence-Based Policies: Essentially active forever, occurrence-based policies cover any loss that happened during the policy term, no matter when the claim is made. It is not unusual for these claims to happen decades later after an unknown side effect of company practices has been discovered. Even if processes have changed, a company may be held responsible for their past actions. Occurrence-based policies have the potential to save you from claims in the future that are completely unforeseeable by you today. Because of their long-term protection, these policies should be kept indefinitely.

Property Policies: Property policies provide coverage for companies in the event there is a loss involving their owned, rented or leased property. Like occurrence-based policies, property policies cover any claim that involves a loss that happened during the term of the policy. However, unlike occurrence-based policy claims, property losses are usually discovered shortly after they occur, limiting how long policy records need to be kept. For such policies, a retention period of six years should adequately cover the chance for claims.

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APPENDIX B - RECORD RETENTION POLICY EXAMPLE - Continued

Claims-Made Policies: Claims-made policies cover claims that are made while the policy is active and, depending on the individual characteristics of the policy, may also include a “tail” that extends coverage for a set period after the policy expires. The tail only covers a claim if it is the result of a loss that occurred during the time when the policy was initially active. The policy’s coverage is based on when a claim is filed and not on the date when the loss occurred. Because there is a limited chance that they will come into play in the long term, six years after the tail expires is an adequate retention period for claims-made policies.

Workers’ Compensation: Time has no effect on an employer’s liability for employee injury. There are many cases where employees are exposed to health hazards that take years to fully develop into a serious condition. This occurs frequently with mining companies whose operations exposed employees to hazardous coal dust before its relation to the development of Black Lung Disease was realized. These companies are still responsible for the exposure no matter how long ago it happened. In these cases, the policy that was in effect at the time can also be triggered to cover the claim. For these reasons, it is important to keep records of workers compensation policies indefinitely.

Employee Benefit Plans: Employee benefits are regulated by the Employee Retirement and Income Security Act of 1974 (ERISA). In Section 107, the Act contains a general records retention regulation that applies to any plan that falls under the ERISA. The regulation requires records to be kept for at least six years after their filing date. While the wording of the regulation does not specifically target the policies themselves, for safety’s sake, it is advised that insurance policy records for employees be kept at least six years to ensure federal compliance.

Retaining the right documents can make life much easier if a claim is filed. While there are limited federal requirements for record retention, the real benefit for a company is ensuring that claims are covered by the appropriate policies to limit any out-of-pocket expense. Evaluate your individual situation before developing your record retention policy. Remember, these are just suggested time frames for document retention – if you feel that your company may need to keep certain records longer, don’t hesitate to do so.

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APPENDIX B - RECORD RETENTION POLICY EXAMPLE - Continued

IRS Recordkeeping Guidelines

Well organized records make it easier to prepare a tax return and help provide answers if your return is selected for examination, or to prepare a response if you receive an IRS notice.

Records such as receipts, canceled checks, and other documents that support an item of income or a deduction, or a credit appearing on a return must be kept so long as they may become material in the administration of any internal revenue law, which generally will be until the period of limitation expires for that return. For assessment of tax you owe, this generally is 3 years from the date you filed the return. Returns filed before the due date are treated as filed on the due date.

There is no period of limitations to assess tax when a return is fraudulent or when no return is filed. If income that you should have reported is not reported, and it is more than 25% of the gross income shown on the return, the time to assess is 6 years from when the return is filed. For filing a claim for credit or refund, the period to make the claim generally is 3 years from the date the original return was filed, or 2 years from the date the tax was paid, whichever is later. For filing a claim for an overpayment resulting from a bad debt deduction or a loss from worthless securities the time to make the claim is 7 years from when the return was due.

Employers must keep all employment tax records for at least 4 years after the tax becomes due or is paid, whichever is later.