



Illinois National Insurance Company

2006 FAJUA Compliance Audit Program

NOTICE: This audit contains private and confidential information of a proprietary nature involving the named servicing carrier and private and confidential information involving certain insureds. Distribution of this audit is restricted to the appropriate Board members only, and, upon request, to the Insurance Department.

**AIPSO
RESIDUAL MARKET AUDIT SERVICES
2006 FLORIDA JUA COMPLIANCE AUDIT
ILLINOIS NATIONAL INSURANCE COMPANY**

REPORT LAYOUT

Summary of Significant Findings:

Provides a summary of the audit findings and contains specific action required of the Board of Governors, if necessary.

Audit Scope:

Provides an explanation of each component of the audit and the time period subject to audit.

Detailed Description of Findings/Recommendations and Servicing Provider Responses:

Provides the audit findings, offers recommendations for corrective action when appropriate, and includes the servicing provider's responses to the findings of the audit team.

Results of Procedures Applied:

Details the results of our testing procedures and makes note, with an asterisk (*), of those areas which are commented on in the body of the report.

SUMMARY OF SIGNIFICANT FINDINGS

This summary contains an overview of the significant audit findings and any action required by the Board of Governors. The Board should review the entire audit report to evaluate Illinois National's performance.

Premium/Commission Charge-offs

- Ineligible Premium Charge-offs, (pgs. 2-3)

We identified three ineligible premium charge-offs totaling \$9,255.

Accounting and Reporting

- ALAE Paid, (pg. 4)

One ALAE paid was reported and paid in excess of the invoice by \$210.

- Unapplied Cash, (pgs. 4-5)

The servicing provider received \$1,610.72 in cash and cannot identify the policy numbers or insured's names to support this amount.

- Accounts Receivable Premium, (pgs. 5-6)

There is a variance between the servicing provider's accounts receivable premium general ledger/AIPSO's sub-ledger balance and policy level detail of \$3,879.20.

- Accrued Commission Payable, (pg. 6)

There is a variance between the servicing provider's accrued commission payable general ledger/AIPSO's sub-ledger balance and policy level detail of \$4,380.34.

It will be in order for the Board of Governors to consider certification of this report for its subscribers.

Report submitted by,



Mark LoVuolo, AIS, API
Manager - Residual Market Audit Services

AUDIT SCOPE

Residual Market Audit Services performed an audit of Illinois National Insurance Company in accordance with the 2006 FAJUA Compliance Audit Program on behalf of the Florida Board of Governors. The audit was conducted during the week of December 4, 2006 at Policy Managers in Rockledge, Florida.

Policy Managers acts as a third party administrator for Illinois National Insurance Company's FAJUA business. All documentation and systems reviewed for this audit was Policy Managers. The audit teams were comprised of the following individuals:

Premium/Commission Charge-offs

Renée Berube - AIPSO Coordinator

Joe Grecco* - Independent Consultant

Accounting and Reporting

Sharon Kay - AIPSO Coordinator

Tammy Till - AIPSO

* Denotes Consultant Team Representative

The scope of the audit included the following:

- **Premium/Commission Charge-off Component:** The premium/commission charge-off component of the audit examined the servicing provider's adherence to FAJUA Plan and Accounting and Statistical Requirements Manuals' charge-off eligibility requirements. The examination also determined the accuracy and timeliness of reporting and compliance with the servicing provider's established billing and collection procedures. In addition, these procedures were reviewed to ensure they are effective in collecting earned premium/return commission due.
- **Accounting and Reporting:** Illinois National Insurance Company's records were examined to ensure there is adequate separation and identification of FAJUA business. The servicing provider's General Ledger (G/L), supporting documentation, and reporting procedures were also examined for compliance with the FAJUA Accounting and Statistical Requirements Manual.

For the month of June 2006, we tested the data reported to the central processor on the Statistical Summary Control Report and Cash Analysis Reports and reviewed associated G/L entries. All reported items were verified to the servicing provider's policy and/or summary level detail, or recalculated to establish their accuracy.

A total of 80 premium/commission charge-off files were examined for the period of June 2004 to September 2006.

PREMIUM/COMMISSION CHARGE-OFFS & RECOVERIES

A total of 80 premium/commission charge-off and recovery files were examined as follows:

Transaction Type	Number of Files	Total Amount
Premium Charge-offs	50	\$84,811.00
Premium Charge-off Recoveries	10	\$21,123.75
Commission Charge-offs	10	\$8,342.00
Commission Charge-off Recoveries	10	\$9,666.60

Recommendations

1. Ineligible Premium Charge-offs

We found three of the 50 premium charge-offs to be fully ineligible. The ineligible amounts total \$9,255 and are detailed below.

Policy Number XA0619126#1, \$599. We found this charge-off to be fully ineligible due to improper policy reinstatement. This policy was originally cancelled on 9/9/03 and the servicing provider issued a refund check on 9/18/03. The servicing provider improperly reinstated the policy on 10/2/03 effective 9/9/03 without having received the refund premium back as required by their procedures. This policy was subsequently cancelled on 2/17/04. According to Chapter 2, Section F of the FAJUA Accounting and Statistical Requirements (A&S) Manual, the servicing provider must take every precaution to avoid providing insurance protection without collecting the appropriate premium. Therefore, this amount is ineligible for reporting and must be reversed and reimbursed to the FAJUA.

Policy Number XA5094811#1, \$850. We found this charge-off to be fully ineligible due to improper policy reinstatement. This policy was originally cancelled on 7/27/03 and the carrier issued a refund check to the premium finance company on 8/13/03. The servicing provider improperly reinstated the policy on 12/9/03 without having received the refund premium back as required by their procedures. This policy was subsequently cancelled on 2/17/04. According to Chapter 2, Section F of the FAJUA A&S Manual, the servicing provider must take every precaution to avoid providing insurance protection without collecting the appropriate premium. Therefore, this amount is ineligible for reporting and must be reversed and reimbursed to the FAJUA.

Policy Number XD6887901#1, \$7,806. We found this charge-off to be fully ineligible due to late completion of the final audit. This policy expired on 2/21/04, and the servicing provider requested the final audit on 7/21/04. The audit was not completed until 10/5/04, 166 days late. Per Chapter 2, Section G.6 of the FAJUA A&S Manual, final audits should be completed within 60 days of the expiration date of the policy. Therefore, this amount is ineligible for reporting and must be reversed and reimbursed to the FAJUA.

Recommendation. We recommend the servicing provider report reversing entries in the next reporting month to the Premium Charge-off line of the Statistical Summary Control Report for \$9,255. In accordance with Chapter 2, Section G of the FAJUA A&S Manual, the servicing provider is also required to deposit funds from its corporate account for the ineligible amounts into the FAJUA Depository Account. The deposit should be recorded as Premium Collections on the Cash Analysis Report.

In order to verify the required reversing entries, policy level detail must be forwarded to Renée Berube of AIPSO's Residual Market Audit Services with the corrections clearly identified. The detail must include the policy number and amount for each transaction reported in the month the reversing entries were made. Please note that the **total** policy level detail must agree to the premium charge-off amount reported on the Statistical Summary Control Report, and the premium collections amount reported on the Depository Cash Analysis.

Illinois National's Response. We agree with the auditors findings of ineligible charge-offs and will make reversing entries for Policy #: XA0619126#1 in the amount of \$599; Policy #: XA5094811#1 in the amount of \$850 and Policy #: XD6887901#1 in the amount of \$7,806 for total reversing entry of \$9,255. These changes will be made with the March, 2007 Financial Filing and all appropriate documentation as requested will be forwarded to RMAS for review.

Carrier Personnel Responsible for Implementation: Judy Semancik-Dodds

Date of Completion: 3/31/07

ACCOUNTING AND REPORTING

Statistical Summary Control Report (SSC)

2. ALAE Paid

In one of the four ALAE payments reviewed, the amount reported and paid was in excess of the invoice by \$210. The payment was for a legal bill in the amount of \$22,228.61. The reported and paid amount was for \$22,438.61.

Illinois National Insurance Company's third party administrator for claims/ALAE payments is York Claims Service, Inc. York Claims Services stated that the overpayment was a transcription error and is in the process of obtaining a refund or credit for the overpayment.

Recommendation. We recommend the servicing provider report the \$210 correction in the next reporting month to the ALAE paid line of the SSC.

In order to verify the required reversing entries, policy level detail must be forwarded to Sharon Kay of AIPSO's Residual Market Services with the corrections clearly identified. The detail must include the policy number and the amount of the transaction reported in the month the reversing entry was made. The total policy level detail must agree to the ALAE paid line of the SSC.

Illinois National's Response. We agree with the auditor's findings and a reversing entry in the amount of \$210 will be made and reported with the March 2007 filing. Documentation of such will be forwarded to RMAS for review.

Carrier Personnel Responsible for Implementation: Judy Semancik-Dodds

Date of Completion: 3/31/07

Cash Analysis

Depository Account

3. Unapplied Cash

The servicing provider reported \$66,251.14 as unapplied cash in June 2006. This unapplied cash represents cash received on policies that have not been set up on the servicing provider's system. This reporting requirement began as a result of the backlog in processing new business in 2002.

The detail includes \$1,610.72 of unidentified cash received from December 2001 through August 2003. The servicing provider cannot identify policy numbers, insured's names, return addresses or any other identifying information to support these cash amounts received. Lacking any identifiable information the servicing provider is unable to apply the funds or return to the proper owner. The servicing provider attempted, but cannot identify where to apply this money.

- **Recommendation.** We recommend the servicing provider submit a write off request for the \$1,610.72 in unidentified cash received to AIPSO's JUA Accounting Department. AIPSO's JUA Accounting Department will review the detail and will recommend options for the Board of Governor's consideration.

Illinois National's Response. Unapplied Cash – As agreed with the auditors we will provide AIPSO's JUA Accounting Department with a potential write off request for \$1,610.72 in unidentified cash received during the period from December, 2001 to August, 2003. The letter will be sent by March 31, 2007. We will wait for a final decision from the Governing Board before making any adjustments.

Carrier Personnel Responsible for Implementation: Judy Semancik-Dodds

Date of Completion: 3/31/07

Observation

Advance Premium Collected

The servicing provider reported unapplied cash of \$13,874 with advance premium collected in June 2006. This amount represents policies with a June 2006 effective date and, therefore, should not be included with advance premium collected.

This was reported as both advance premium collected and unapplied cash; therefore, accounts receivable premium was overstated by \$13,874. These amounts are automatically reversed the following month by AIPSO's JUA Accounting Department and no correcting entry is needed.

Trial Balance Reconciliation

When the servicing provider submits the Statistical Summary Control and Cash Analysis Reports to AIPSO each month, AIPSO's JUA Accounting Department enters the individual transaction from each report to AIPSO's sub-ledger (a ledger system) to mirror the general ledger and trial balance maintained by the servicing provider. At the end of each quarter, AIPSO's JUA Accounting Department prepares a document called the "Trial Balance Reconciliation." This document compares the balances from AIPSO's sub-ledger to the balances reported on the servicing provider's trial balance (T/B) for specific accounts. These balances represent inception to date amounts. If any variances or unusual amounts are identified, the servicing provider is immediately asked to reconcile them.

4. Accounts Receivable Premium

The servicing provider's general ledger balance and AIPSO's sub-ledger balance (net of advance premium collected and unapplied cash) of \$423,414.77 did not agree with the policy level detail of \$419,535.57; a variance of \$3,879.20. This variance occurred during the processing of the high volume business from 2001 through 2004.

Two different processing systems were utilized during this time and due to deficiencies in one of the processing systems, variances resulted. The servicing provider resolved the majority of variances but could not resolve the \$3,879.20. This variance has remained the same since the servicing provider's 2005 audit.

Recommendation. We recommend the servicing provider submit a request to AIPSO's JUA Accounting Department for the potential write-off of the variance of \$3,879.20. AIPSO's JUA Accounting Department will review the detail and will recommend options for the Board of Governors' consideration.

Illinois National's Response. Accounts Receivable Premium – We are in agreement with Recommendation #4 and will provide a written request to AIPSO's JUA Accounting Department for the potential write-off of the variance of \$3,879.20, which has continued to remain the same since the 2005 Audit. We will wait for a final decision by the Governing Board before making any adjustments.

Carrier Personnel Responsible for Implementation: Judy Semancik-Dodds

Date of Completion: 3/31/07

5. **Accrued Commissions Payable**

The servicing provider's general ledger balance and AIPSO's sub-ledger balance of (\$15,722.31) did not agree with the policy level detail of (\$20,102.65); a variance of \$4,380.34.

This variance resulted during the processing of the high volume business from 2001 through 2004. As noted in Finding 4, deficiencies in one of processing systems used during this time resulted in variances. The servicing provider resolved all but \$4,380.34 of the variance. This variance has remained constant since the servicing provider's 2005 audit.

Recommendation. We recommend the servicing provider submit a request to AIPSO's JUA Accounting Department for the potential write-off of the variance of \$4,380.34. AIPSO's JUA Accounting Department will review the detail and will recommend options for the Board of Governor's consideration.

Illinois National's Response. Accrued Commissions Payable – We are in agreement with Recommendation # 5 and will provide a written request to AIPSO's JUA Accounting Department for the potential write-off of \$4,380.34, which occurred during the high volume period from 2001 through 2004. We will wait for a final decision by the Governing Board before making any adjustments.

Carrier Personnel Responsible for Implementation: Judy Semancik-Dodds

Date of Completion: 3/31/07

AIPSO
 RESIDUAL MARKET AUDIT SERVICES
 2006 FAJUA COMPLIANCE AUDIT
 ILLINOIS NATIONAL INSURANCE COMPANY
 RESULTS OF PROCEDURES APPLIED

PREMIUM CHARGE OFFS

<u>Question</u>	<u>Total Reviewed</u>	<u>Total Qualified</u>	<u>Number of Exceptions</u>	<u>Accuracy Percentage</u>	<u>Report Finding</u>
1 Does the premium charge-off amount listed on the sample selection agree to the documentation in the policy file?	80	50	0	100%	
2 Was the charge-off reported in a timely manner (within a month from the date the charge-off was written off by the servicing provider)?	80	50	0	100%	
3 Was the reason for the cancellation documented in the policy file?	80	36	0	100%	
4 Was proper advance notice of cancellation sent to the insured?	80	34	0	100%	
5 Was the cancellation processed in a timely manner?	80	34	1	97%	
6a Were filings cancelled with the proper effective date?	80	0	0	N/A	
6b Were filings cancelled giving proper notice in accordance with Federal/State Plan rules or regulations?	80	0	0	N/A	
7a Was the proper pro-rata factor used?	80	36	0	100%	
7b Was only the uncollected earned premium included in the reported premium charge-off amount?	80	50	0	100%	
8 Was the issuance of the new business policy, endorsement, or renewal within FAJUA standards?	80	50	0	100%	
9a Policies without PIP and PD: If the policy was received with an insufficient deposit premium, was the policy cancelled within 24 days from determination of the shortage?	80	0	0	N/A	
9b Policies with PIP and PD: If the policy was received with an insufficient deposit premium, was the policy cancelled on the 61st day after the policy effective date?	80	7	0	100%	
10a If the down payment check was returned by the bank for any reason, was the policy cancelled flat?	80	0	0	N/A	
10b If a check for a payment other than the deposit was returned by the bank for any reason, was the policy cancelled within 15 days of receipt from the bank?	80	0	0	N/A	

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RESULTS OF PROCEDURES APPLIED

PREMIUM CHARGE OFFS

<u>Question</u>	<u>Total Reviewed</u>	<u>Total Qualified</u>	<u>Number of Exceptions</u>	<u>Accuracy Percentage</u>	<u>Report Finding</u>
11 If a policy was received with a short installment amount, was the shortage collected or coverage terminated within 40 days from determination of shortage (receipt)?	80	0	0	N/A	
12 Did the servicing provider NOT suspend or extend the due date of an installment due to a non-premium endorsement?	80	0	0	N/A	
13 Was the cancellation notice sent within 7 days of the due date of the first unpaid bill?	80	23	2	91%	
14 Was the cancellation effective date within 30 days (45 if premium disputed) from the due date of the first unpaid bill?	80	22	2	91%	
15 Prior to 8/25/04: Were at least two letters requesting immediate payment of the outstanding earned premium due issued a minimum of 15 days apart, with both letters being issued within 45 days from the cancellation effective date?	80	9	0	100%	
16 Subsequent to 8/25/04: Was a collection letter requesting immediate payment of the outstanding earned premium due issued within 15 days from the cancellation effective date?	80	40	0	100%	
17a If the premium charged off developed on a renewal policy, did the insured accept the renewal by payment?	80	7	0	100%	
17b Was the insured eligible for renewal?	80	7	0	100%	
18a Was the return premium properly refunded to the premium finance company?	80	1	0	100%	
18b Was the earned premium owed to a finance company or collection agency that was not owned by, or under common ownership with, the Servicing Provider?	80	1	0	100%	
19a Was the audit completed within 60 days from the policy cancellation/expiration?	80	3	1	67%	
19b Was the audit premium billed within 21 days from the audit's completion?	80	3	0	100%	
19c Was at least one letter requesting payment of the audit premium issued within 15 days from the due date of the final premium audit bill?	80	3	0	100%	
19d Once the audit premium was developed, did the servicing provider follow its established collection procedures to collect the amount due?	80	3	0	100%	

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RESULTS OF PROCEDURES APPLIED**

PREMIUM CHARGE OFFS

<u>Question</u>	<u>Total Reviewed</u>	<u>Total Qualified</u>	<u>Number of Exceptions</u>	<u>Accuracy Percentage</u>	<u>Report Finding</u>
20 Did the servicing provider report the charge-off within 120 days of the policy becoming delinquent?	80	50	0	100%	
21 Did the servicing provider take every precaution to avoid providing insurance protection without collecting the appropriate premium?	80	50	2	96%	*
22 Is the reported premium charge-off amount eligible?	80	50	3	94%	*
23a Was the proper recovery amount received from the attorney or collection agency?	80	20	0	100%	
23b Was the recovery properly reported to AIPSO and was it timely (within one month from receipt)?	80	20	0	100%	
23c If a compromise or settlement of the outstanding amount due from the insured has been agreed upon, has the agreed upon amount been reported to AIPSO and do the servicing provider's accounting records indicate it?	80	0	0	N/A	
23d Was the commission NOT paid on any audit premium recoveries received from a collection agency, or paid directly to the servicing provider?	80	0	0	N/A	
24a Does the commission charge-off amount reported on the policy level detail agree to the policy file?	80	10	0	100%	
24b Was the commission charge-off reported in the month written off by the servicing provider?	80	10	0	100%	
24c Was the producer commission rate correct at the inception of the policy?	80	10	0	100%	
24d Did the provider send a monthly report of return commission greater than \$100 uncollected more than 60 days to the FAJUA?	80	10	0	100%	
25 SERVICING PROVIDER PROCEDURE: Was the first collection letter issued a minimum of 15 days from the cancellation effective date?	80	49	0	100%	
26 SERVICING PROVIDER PROCEDURE: Prior to 8/25/04: Was the second collection letter issued a minimum of 15 days from the issuance date of the first letter?	80	9	0	100%	
27 SERVICING PROVIDER PROCEDURE: Subsequent to 6/1/04: Was any balance equal to or greater than \$750 that remained outstanding for 60-90 days after the cancellation/expiration effective date referred to a collection agency?	80	16	0	100%	

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PREMIUM CHARGE OFFS

<u>Question</u>	<u>Total Reviewed</u>	<u>Total Qualified</u>	<u>Number of Exceptions</u>	<u>Accuracy Percentage</u>	<u>Report Finding</u>
28 SERVICING PROVIDER PROCEDURE: Subsequent to 6/1/04: Was any balance equal to or greater than \$750 charged off the system and reported to AIPSO in a timely manner?	80	16	0	100%	
29 SERVICING PROVIDER PROCEDURE: Subsequent to 6/1/04: Was any balance less than \$750 charged off the system and reported to AIPSO in a timely manner?	80	33	0	100%	
30 For charge-offs NOT resulting from uncollected audit premium: Did the servicing provider follow their own billing and collection procedures?	80	47	0	100%	
31 Have all the issues pertaining to this policy been addressed?	80	80	0	100%	