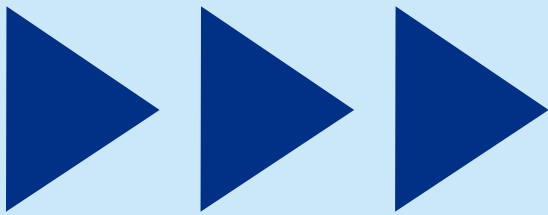
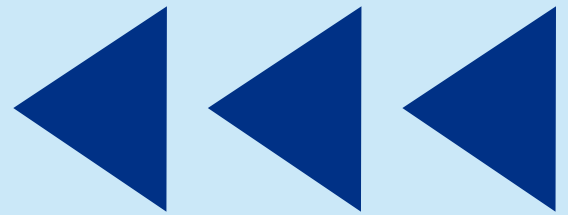


# AGENCY SELF-ASSESSMENT AUDIT GUIDE



**SIX-STEP  
AUDIT  
PROCESS**



# AGENCY SELF-ASSESSMENT AUDIT GUIDE

An agency can conduct a self-audit to check compliance with insurance statutes/rules by assembling either an internal/external audit team with accounting and insurance expertise to conduct the audit. This agency audit team should have access to agency principal/owner(s) and staff to conduct interviews in order to gather the necessary information to complete the audit. The audit may be conducted utilizing the following six step audit process:

## SIX STEP AUDIT PROCESS

### 1) Gather Appropriate Documentation

The agency principal or office manager may gather all or some of the following information for the audit process:

- Agency bank accounts (number of accounts and explanation of how they are used)
- Premium bank statements for past five years
- Check stub records for all accounts
- Premium receipts for past five years
- Premium deposit records for past five years
- Premium remittance transmittal records for past five years
- Daily premium reconciliation records for past five years
- Non-sufficient funds notices on the premium account for past five years
- Account current records for past five years
- Premium volume and policy count by line of business
- Company rating exception pages if deviated from ISO or Rate Bureau
- Premium account ledgers (manual or automated) for past five years

The audit team may request additional documents during the course of the audit based on findings developed.

### 2) Discuss Scope of the Examination

The audit team should discuss the audit scope and prepare a strategy, including an estimated timeframe, to complete their audit. For example, scope of the audit may include:

1. Agency Overview
2. Licensing and Appointments Review
  - \* Continuing Education
3. Rating and Underwriting
  - \* Private Passenger Automobile
  - \* Commercial Automobile
  - \* Homeowners
  - \* Workers Compensation
  - \* General Liability
  - \* Excess Liability, Commercial Umbrella, Professional Liability

- \* Other Liability
- \* Surplus Lines
- \* Life and Health-Medicare Supplement/Long Term Care

4. Financial Management
5. Cancellations, Terminations, and Non-renewals
6. Marketing
7. Advertising and Sales
8. Observations/Conclusions
9. Recommendations

### **3) Conduct an Audit Interview**

The audit team should set up a meeting with the agency principal/owner(s) and office manager to conduct an interview and discuss the scope/process for the audit. The audit team may also inquire if the agency principal/owner(s) has any specific areas of concern to share that they would like reviewed during the audit process. All or some of the following list of information may be elicited from the agency principal/owner(s) to be reviewed during the audit process to develop an overview of the agency and be included in the audit report:

- Name and title of the agency principal/owner(s);
- Brief history of the agency and years in business;
- Website and address of agency;
- Experience level of principal/owners(s);
- Incorporation documentation if agency is a corporation registered with the North Carolina Secretary of State;
- Number of employees and their level of experience;
- Number of years these employees have been with agency;
- Licensing information for each employee;
- Description of each employees roles and responsibilities in the office;
- What premium finance company, if any, does the agency use;
- Whether there any branch offices for this agency;
- What companies is the agency doing business with;
- Which companies are the producers appointed with;
- Which companies does the agency have brokerage agreements;
- Which are the main writing companies the agency represents;
- Provide the number and types of bank accounts;
  - 1.) Premium Account Separate from Operating Account
  - 2.) Combined Premium and Operating Account
  - 3.) Personal Lines and Commercial Accounts Separate
- How are companies paid premiums;
  - 1.) Sweeping (identify companies)
  - 2.) Checks issued (identify companies)
- Where the insurance financial records are being housed or stored;
- Is there is a manual or system accounting system;
- What type of billing arrangements does the agency maintain:

- 1.) Direct bill;
  - 2.) Account current;
  - 2.) If the agency maintains both billing arrangements, identify the percentage for each type
- If agency accepts direct bill payments in the office:
    - What payment forms are accepted (i.e. cash, check, money order, etc.)
    - Does the agency provide a receipt for these payments?
  - Does the agency charge any service or policy fees?

#### **4) Conduct the Agency Audit**

The audit team may utilize the information gathered during the previous steps of the audit process to conduct the audit. This includes a detailed review of financial documents, policy files, licensing/appointment status of agency staff, agency procedures, internal controls, and compliance with applicable insurance regulations. Any unusual trends or relationships discovered during the audit process may result in further inquiries and be listed in the audit report.

#### **AGENCY REVIEW**

If agency is a corporation registered with the North Carolina Secretary of State (SOSNC), the audit team may review incorporation documentation. A check of the corporation name on the SOSNC online lookup may be completed to verify that the corporation registration is active and the information on registered agent and address is current:

<https://www.sosnc.gov/search/index/csl>

Review of agency website and sales/marketing material should verify that the agency is doing business in the corporation name unless official Doing Business As (DBA) paperwork has been filed in the office of the register of deeds of such county where the agency is located.

The audit team may also review the security of personally identifiable information (PII) collected by the agency to ensure that it is being secured and handled appropriately.

#### **LICENSING AND APPOINTMENT REVIEW**

The audit team may use the National Producer Numbers (NPN) of all licensed insurance producers in the agency to verify compliance with the statutes regarding licensing and appointments through the license status online lookup on the Department of Insurance website [www.ncdoi.com](http://www.ncdoi.com), Agent Services Division, under Online Services:

- Insurance producer license types
- Insurance producer appointments

The audit team may verify that insurance producers are not writing business for companies in which they have not been appointed or acting as an agent for a line of business for which they are not licensed. The audit team may check that the applicable insurance producers have a broker's license if they broker business for the agency.

The audit team may also review the description of each employee's roles and responsibilities in the office to ensure that the activities they perform fall within their license authority or fall under administrative duties for unlicensed support staff. Auditors may also observe the activities of

licensed and unlicensed staff during the course of the audit to determine compliance with the insurance regulations regarding licensing and appointments.

The audit team may also verify compliance with continuing education requirements through the continuing education status online lookup on the Department of Insurance website [www.ncdoi.com](http://www.ncdoi.com), Agent Services Division, under Online Services.

## **RATING AND UNDERWRITING**

The audit team may review a random selection of agency files in order to have a representative population of the business which has been submitted to the companies. The audit team may review the files to assure the proper underwriting information is being used in rating the policies and the placing of coverage.

- **Review and Verification of Underwriting Information**

Some of the underwriting information that may be reviewed and verified includes:

- \* rating territories
- \* construction type
- \* usage codes
- \* age of risk
- \* protection classes
- \* proper signatures
- \* rating symbols
- \* coverage limits
- \* occupancy
- \* appropriate coverages
- \* occupation
- \* loss history
- \* signature of insured
- \* UM/UIM forms
- \* Life/Health risk factors
- \* Life/Health forms properly signed

- **Private Passenger Automobile Coverage**

The audit team may review and substantiate the information contained on the application of insurance and renewals supplied by the insurance producer to ensure conformity with **NC General Statute §58-33-105**, false statements in applications for insurance. The audit team may verify the kinds of information to be detailed on the subject vehicle as follows:

- The audit team may review a random sampling of policies using the North Carolina Personal Automobile Manual, applying company approved deviations where applicable.

- The audit team may confirm company deviations on file are approved by the NCDOI.
- The audit team may review a random sampling of policies to ensure that vehicle identification numbers and symbols are clearly shown for each vehicle insured on the policies being reviewed; distance traveled on a daily basis; age of the vehicle; vehicle usage category; territory rating verification based on the **North Carolina Rate Bureau (NCRB)** territory definitions in effect on the inception date of the policy; policy holder change in employment category; class codes; safe driver insurance points assessment; inexperienced operators miscellaneous coverage; non-owned liability coverage, policy rates as dictated by the **North Carolina Reinsurance Facility (NCRF)** for rates without deviations.

- **Homeowner Coverage**

- The audit team may review a random sampling of policies to substantiate the information contained on the application for insurance.
- The following rating factors may be verified using the **Homeowners Manual**:
  - a. Territory
  - b. Fire District
  - c. Protection/Construction Class
- Verification of risks may include: reviewing the risk, confirming correct fire district and rating which may include a call to the local county/city fire department.
- The audit team may review and compare the coverages and limits as requested on the application to those shown on the policy declaration page. The audit team may look for any trends that may indicate unfair application of rates or underwriting guidelines.
- The audit team may review the procedures used by the agent when procuring insurance through NCJUA/NCIUA to confirm that the agency is following all rules and procedures of the governing organizations and insurance regulations.

- **Worker's Compensation**

- The audit team may review a random sampling of policies to verify proper job classification codes are applied as defined in the established **Workers' Compensation Manual**. In addition to the codes, the audit team may verify application of payroll limits, experience factors, coverage exclusions, and payroll audit processes.

- **General Liability**

The audit team may review a random sampling of policies and verify classification codes from the Commercial Lines classification table. This table will also indicate the premium basis for the lines of coverage, (i.e., sales, square footage, unit, etc.).

- **Excess Liability, Commercial Umbrella, & Personal Umbrella Coverages**

The audit team may review a random sampling of policies to verify the underlying policies and limits indicated on the policy/application are correct.

- **Commercial Automobile Liability Coverages**

The audit team may review a random sampling of commercial automobile policies to verify the usage, territory, size (weight) of the vehicle, and radius of use in addition to information required to be gather based on commercial rate evasion insurance regulations pursuant to **NC General Statute §58-2-164**.

- **Surplus Lines**

The audit team may review a random sampling of surplus lines policies to ensure compliance with **Article 21, of Chapter 58, of the North Carolina General Statutes - Surplus Lines Act**.

- **Life and Health-Medicare Supplement/Long Term Care**

The audit team may review a random sampling of Life & Health and Medicare Supplement/Long Term Care policies to ensure compliance with **Articles 53, 54, 55, 58, of Chapter 58, of the North Carolina General Statutes and Chapter 12, of Title 11, of the North Carolina Administrative Code**.

## **FINANCIAL MANAGEMENT**

### **Accounting Review Process**

The audit team may review and verify accounting entries from various source documents including electronic data processing printouts and other books of accounts, and supporting financial records. In performing the audit, the audit team may perform spot checks and rely on the following **agency financial records**:

- **Five years of Premium Bank Statements**
- **Premium Deposit records for past five years**
- **Premium Remittance transmittal records for past five years**
- **Daily premium reconciliation records for past five years**
- **Non-sufficient funds notices on premium account for past five years**
- **Premium Receipts**
- **Cancelled Checks**
- **Check Stub Book**
- **Premium Account ledgers (manual or automated) for past five years**

Purpose of accounting review is to:

1. Verify accuracy of the accounts receivable and accounts payable;
2. Review bank statements and identify possible discrepancies with premium remittance to insurers;
3. Verify that premium funds were not used for operating expenses or personal use
  - The audit team may review the premium only accounts to ensure that the agency is not writing non-premium checks from this account.
  - The audit team may review the bank statements for insufficient funds, bank charges, credit lines usage, and negative balances.
  - A review of the financial records may include an analysis of the receipts and verifying premium remittances to the proper insurance companies and/or premium finance companies. The premium accounts within the agency may be reviewed to determine compliance with the anti-commingling regulation under administrative code rule **11 NCAC 4.0429**.
  - The audit team may review the monthly statements to ensure that credits and refunds to the insurers/clients are handled properly.
  - The audit team may match cash receipts and disbursements to invoices, bank accounts, voucher register, and receipts register, verify the accuracy of general ledgers, journals, and subsidiary ledgers. Deposits made may be reconciled with cash and checks on premium received.
  - If agency accepts direct bill payments in the office, the audit team may check that the agency is in compliance with the receipt administrative code rule **11 NCAC 4.0121** by randomly checking receipts.
  - If the agency charges policy or service fees, the audit team may determine what specific fees are charged and note if there is a sign posted where the customers usually conduct business that clearly states the schedule of fees.
    - The audit team may also confirm the agency's procedures as relates to policy or service fees pursuant to **NC General Statute §58-33-85 (b)** and **11 NCAC 4.0120**.
    - While undergoing the examination, the audit team may review the consumer consent forms and receipts in connection with the use of any of these fees.

### **CANCELLATIONS, NONRENEWALS, TERMINATIONS**

The audit team may review inactive policies to determine company compliance with the statutes and rules governing the specific lines of business.

### **MARKETING**

The audit team may review the marketing activities of the agency and determine if there is a referral fee activity. If so, these activities may be reviewed to verify compliance with commission



payments, rebating, and unfair trade practice regulations pursuant to **NC General Statutes §§58-33-82, 58-33-85, 58-63-10 and 58-63-15.**

### **ADVERTISING AND SALES**

Many product advertising materials must be approved by the Life and Health Division of the NCDOI prior to use by the agency. Those products include Long-Term Care, Annuities, Medicare Supplement, and Interest Sensitive Life. All advertisements, regardless of by whom written, created, designed or presented, shall be the responsibility of the insurer. The Life & Health Division reviews these materials when submitted by insurers and will hold insurers responsible for advertising materials.

- The audit team may review the advertising material for products to determine if the agency is using any unapproved advertising material that require approval prior to use. **North Carolina Administrative Code 11 NCAC 12.0517** defines accident and health advertisements to include the following:
  - 1) printed and published material, audio visual material and descriptive literature of an insurer used in direct mail, newspapers, magazines, radio scripts, TV scripts, billboards and similar displays; and
  - 2) descriptive literature and sales aids of ALL kinds issued by an insurer, agent or broker for presentation to members of the insurance buying public, including but not limited to circulars, leaflets, booklets, depictions, illustrations and form letters; and
  - 3) prepared sales talks, presentations and material for use by agents, brokers and solicitors.
  
- North Carolina Administrative Code **11 NCAC 12.0424** defines life insurance and annuity advertising to include all of above definitions found in accident and health advertisements and also adds:
  - 4) material designed to create public interest in life insurance or annuities or in an insurer, or to induce the public to purchase, increase, modify, reinstate, borrow on, surrender, replace or retain a policy;
  - 5) material used for recruitment, training, and education of an insurer's sales personnel, agents, solicitors, and brokers which is designed to be used or is used to induce the public to purchase, increase, modify, reinstate, borrow on, surrender, replace or retain a policy.
  
- The audit team may review sales practices to determine if there were any inappropriate referral fees practices or if any inducement/rebates have been paid by the agency.

### **5) Draft an Audit Report**

- The audit team should prepare a written report and summary of the audit. Audit report may include the following headings to report appropriate information and findings gathered during the previous steps of the audit process:

1. Agency Overview
2. Licensing and Appointments
3. Rating and Underwriting
4. Financial Management
5. Cancellations, Terminations, and Non-renewals
6. Marketing
7. Advertising and Sales
8. Observations/Conclusions
9. Recommendations

- The audit report may also include recommended solutions to any issues or problems described in the report along with a suggested timeframe for corrective actions to be implemented.

#### **6) Conduct a Closing Interview**

The audit team may provide a copy of the draft audit report to the agency principal/owner(s) and deliver a verbal executive summary including any adverse findings along with their recommendations. The agency principal/owner(s) may request further explanation of audit findings or provide clarification/corrections to any information contained in the report. The audit team may solicit a response from the agency principal/owner(s) on whether they agree or disagree with any issues or problems cited in the report and if they plan to implement corrective actions. The audit report may then be updated to include the information gathered in the closing interview and finalized.