

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC DEVELOPMENT
DIVISION OF INSURANCE
PO BOX 110805
JUNEAU, AK 99811-0805

Order # TA 06-04)
In the Matter of Audit of)
Parker, Smith & Feek Inc)
_____)

FINDINGS OF FACT

1. An audit report of Parker, Smith & Feek Inc, licensed in the State of Alaska, has been issued by the State of Alaska, Division of Insurance to Parker, Smith & Feek Inc.
2. The audit report of Parker, Smith & Feek Inc (TA 06-04) has been transmitted to Charles Szopa, Compliance Officer, Parker, Smith & Feek Inc (Auditee), and Auditee has been accorded at least 30 days' opportunity to review and comment on this audit report.
3. The director of the Division of Insurance has fully considered and reviewed the report and any relevant portions of the auditor's work papers to the extent she considered necessary.

CONCLUSIONS OF LAW

1. The written audit report referred to in Finding of Fact No. 1 was issued in accordance with Alaska Statute (AS) 21.06.150(b).
2. The actions set forth in finding of Fact No. 2 were conducted in accordance with AS 21.06.150(b).
3. The director of the Division of Insurance has reviewed the audit report and any other relevant work papers as set forth in Finding of Fact No. 3 to the extent she considered necessary in accordance with AS 21.06.150(b).

ORDER

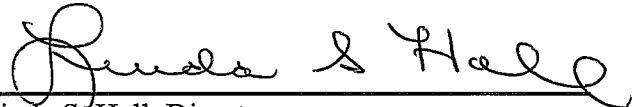
IT IS ORDERED

1. Pursuant to AS 21.06.150(b)(1), the audit report of Parker, Smith & Feek Inc (TA 06-04) is approved as filed.

2. Pursuant to AS 21.06.060, the audit report shall be kept in the office of the director of the Division of Insurance and be open to public inspection.

This order is effective July 5, 2007.

Dated this 5th day of July, 2007 at Anchorage, Alaska.



Linda S. Hall, Director
State of Alaska
Division of Insurance

PREMIUM TAX AUDIT OF

**Parker, Smith & Feek Inc
Anchorage, AK**

TA 06-04

As of December 31, 2005

**Issued by
DIVISION OF INSURANCE
DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC
DEVELOPMENT
STATE OF ALASKA**



**FINAL REPORT:
JULY 5, 2007**

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DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT
Division of Insurance

Frank H. Murkowski, Governor
Emil Notti, Commissioner
Linda S. Hall, Director

April 25, 2007

Linda S. Hall, CPCU, CIC
Director, Division of Insurance
Department of Commerce, Community and Economic Development
550 West 7th Avenue, Suite 1560
Anchorage, AK 99501-3567

Pursuant to Alaska Statute (AS) 21.06.130, the Alaska Division of Insurance performed a limited and targeted premium tax audit of Parker, Smith & Feek Inc (the broker) on December 11, 2006 through December 15, 2006, in the broker's Anchorage office. The audit was conducted by Rebecca Nesheim, tax auditor for the Alaska Division of Insurance.

Parker, Smith & Feek Inc

SCOPE OF AUDIT

This premium tax audit was called to review compliance with the surplus lines statutes AS 21.34, and regulations 3 AAC 25 and the premium tax regulations 3 AAC 21.550 – 570. This is the first premium tax audit of Parker, Smith & Feek Inc conducted by the Alaska Division of Insurance.

Subject Matters Audited

Parker, Smith & Feek Inc is a licensed surplus lines broker in Anchorage, Alaska. As this agency ranked number six in premium volume among all Anchorage surplus lines brokers in 2005 for premium tax and filing fees paid, the division elected to audit their monthly filings, premium taxes paid, and filing fees paid, for accuracy and timeliness.

Time Frame

The audit covered this broker's surplus lines business for the two years of January 1, 2004 through December 31, 2005.

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METHODOLOGY

The tax auditor sent the call letter and initial data requests to Parker, Smith & Feek Inc's office in Anchorage, AK. A list of all Alaska surplus lines business transactions was requested for the period to be audited. Parker, Smith & Feek Inc complied timely with all data requests. The number of policies and endorsements written during the audit period was 61, from which a sample of 50 files was selected for audit. One policy was deleted from the audit while the tax auditor was in Anchorage as it was actually another surplus lines broker's responsibility to file and Parker, Smith & Feek Inc did not file paperwork with the Division. Thus, the remaining 49 files were audited.

The following are the procedures steps for the audit:

- 1) Verify that monthly premium report summaries and report of surplus lines transactions were filed in a timely manner.
 - i) Audit steps taken:
 - (1) Verified the monthly reports were filed timely with the Alaska Division of Insurance as required by statute.
 - (2) Verified the affidavit of due diligence was filed with the Alaska Division of Insurance as required by statute for those policies effective prior to July 1, 2004.
 - (3) Verified a statement of exempt premiums was filed when appropriate.
- 2) Verify the accuracy of the premium calculation
 - i) Audit steps taken:
 - (1) Reviewed policy, declaration page, and invoices to determine how they calculated the premium.
 - (2) Verified the correct premium was reported on the monthly reports as filed.
- 3) Verify the accuracy of all monthly reports filed.
 - i) Audit steps taken:
 - (1) Reviewed the policy & declaration pages in each file.
 - (2) If the effective date did not match the monthly filing, reviewed the correspondence to ensure the documentation in the file matched when the policy was booked. Most of these occurred with endorsements that often require additional information and sometimes company approval before it can be added to the policy. The effective date may be a month or more prior to the actual book date or invoice date. In this case, the invoice date usually determined in which month the endorsement is required to be filed.
 - (3) Verified the monthly reports as filed with the division were accurately filled out to reflect the correct effective date, premiums, taxes and fees based upon the information in the files.
- 4) If the placement is a multi-state placement, check the calculation and reasonableness of the methodology to allocate.
 - i) Audit steps taken:
 - (1) Verified the allocation of premium for each state is reasonable and the calculation is accurate.
- 5) Verify quarterly and annual premium tax reports were filed in a timely manner.
 - i) Audit steps taken:

- (1) Confirmed when the quarterly and annual premium tax reports were mailed to the Alaska Division of Insurance.
- 6) Verify the accuracy of the quarterly and annual premium tax reports
 - i) Audit steps taken:
 - (1) Verified the quarterly and annual premium tax reports as filed with the division were accurately filled out to reflect the correct premiums, taxes and fees.
- 7) Verify if tax and filing fee payments were made timely and by ACH
 - i) Audit steps taken:
 - (1) Confirmed when the payments were made to the Alaska Division of Insurance and the payment method
- 8) Verify tax and filing fees payments were made accurately
 - i) Audit steps taken:
 - (1) Confirmed if the tax and fee payments matched the quarterly or annual tax reports as filed.
- 9) Review effort made to place insured with an admitted insurer
 - i) Audit steps taken:
 - (1) Verified an affidavit of due diligence was in the file and the declinations filled out. If it was marked as using the placement list, the list effective at the time of placement was reviewed to ensure the risk was on the list
- 10) Review disclosures for use of non-admitted insurer
 - i) Audit steps taken:
 - (1) Reviewed the correspondence and other documentation in the files to find a copy of the notification sent to the insured that meets the requirement in AS 21.34.110
 - (2) Reviewed the evidence of insurance to confirm the required language in AS 21.34.100(e) was on every document.
- 11) Confirm coverage is placed with an eligible non-admitted insurer
 - i) Audit steps taken:
 - (1) Reviewed the white lists to ensure the company was eligible at the time of placement
- 12) Review notice regarding nonrenewal and premium increase
 - i) Audit steps taken:
 - (1) Verified in each file there was a policyholder notice regarding nonrenewal and premium increase included with the policy or other evidence of insurance.

Acceptable Error Rate:

The Broker's acceptable error rate for the above referenced standards and tests must be less than 10%.

PREMIUM TAX AUDIT

- | |
|--|
| <ol style="list-style-type: none">1. Verify that monthly premium reports and accompanying forms were filed in a timely manner
AS 21.34.080 and.170, 3 AAC 25.100 and 25.090 |
|--|

Comments: Four monthly filings were filed late with the Alaska Division of Insurance. Several others were filed timely but unsigned for which a timely notification was sent to the Division that the surplus lines broker was unavailable to sign the reports but they would be forthcoming. At

that time, the unsigned monthly reports were accepted by the Division as filed as there was no penalty in place for late filing and the issue of signed or unsigned was not brought up. Therefore, for this audit, those unsigned filings with timely notification to the Division were allowed as filed on time but impressed upon them the importance of filing only signed reports.

Result: Failed (20 months passed & 4 failed, error rate 16.67%)

Observations: The compliance officer is often in travel status at the end of the month when a report needs to be filed.

Recommendations: It is recommended that Parker, Smith & Feek Inc update the written procedure manual to ensure the monthly reports are filed timely. If the compliance officer will be unavailable towards the end of the month, consider filing the monthly report earlier in order for the report to be complete and signed when filed. One method for maintaining a record of when the filing was made would be to send the monthly report certified.

Parker, Smith & Feek Inc response to exception report 1/31/07: A new written procedure has been set up to ensure that all monthly reports are signed and filed prior to the due date. Each report will be mailed to the State of Alaska via Certified Mail prior to the due date.

Division of Insurance subsequent Response: Although Parker, Smith & Feek Inc prefers to have the surplus lines compliance officer sign the reports, the firm has six other licensed surplus lines brokers and any one of them can sign the necessary forms per statute if the compliance officer is unavailable when the reports are ready to be filed.

2. Verify the accuracy of the premium calculation

AS 21.34.180

Comments: The current procedure is to double check copies of invoices, policies, and binders against a report received from the Bellevue office to confirm the premium amounts are correct at the time the monthly report is prepared. As this is a manual process, inspection fees and policy fees were missed in calculating premium at the time invoices were prepared for two policies. The incorrect premium resulted in not enough premium taxes and filing fees charged the insured and paid to the Alaska Division of Insurance. In response to the exception report, the two policies were evaluated by the broker. In one, broker fees were erroneously included in the calculation of premium besides the missed inspection fees resulting in excess tax and fees charged the insured and remitted to the division. The other was found to have been miscoded as a surplus lines placement for the broker to file when in fact they acted as the producer in the transaction and it was not their responsibility to file the report. An amended report taking this policy out of the monthly report was submitted prior to the audit and is no longer considered an error. Tax and fees due to the insured for the one policy is \$16.61 and \$6.15 respectively for a total refund due the insured of \$22.76.

The incorrect premium error affects three other tests in the audit:

1. Accuracy of the monthly report
2. Accuracy of the quarterly and annual tax reports

3. Accuracy of the premium tax and filing fee payments.

Result: Passed (48 files passed & 1 failed, error rate 2%)

Observations: The manual process created by Parker, Smith & Feek Inc for premium calculation is prone to errors.

Recommendations: It is recommended that Parker, Smith & Feek Inc update the written procedure manual to ensure no company fees are missed through the invoicing system Sagitta when compiling the monthly premium reports

Parker, Smith & Feek Inc Response to initial exception report 1/31/07: Parker, Smith & Feek, Inc. has implemented a new procedure which requires a 2nd person to review each monthly, quarterly and annual report. We are also in the process of reviewing and changing our procedures for completing the monthly surplus lines tax reports. This should avoid any coding error and subsequent billing discrepancies.

Division of Insurance response: The corrected premium was reported on an amended report received with the response to the exception report.

3. Verify the accuracy of all monthly reports filed

AS 21.34.080 and .170, 3 AAC 25.090 and 25.100

Comments: All policy information is input into the computer system, Sagitta, for purposes of creating an invoice. Each invoice then shows up on a report from the Bellevue office used in the Anchorage office to prepare the monthly report forms. The report contains only those transactions that were correctly coded as surplus lines transactions the broker must file. Five files included paperwork that was not reflected in the monthly report accurately. The issues ranged from endorsements not filed in the right month to not being filed at all, to installment premium payments not reported at all. Reporting premium in installments does not meet statute requirements. The broker was notified via email to discontinue reporting installments. The premiums not reported results in tax and filing fees of \$115.21 and \$1,370.30 respectively for a total due of \$1,485.51.

The inaccurate monthly reports affects two other tests in the audit:

1. Accuracy of the quarterly and annual tax reports
2. Accuracy of the premium tax and filing fee payments.

Result: Failed (44 files passed & 5 failed, error rate 10%)

Observations: The manual process created by Parker, Smith & Feek Inc for report completion is prone to errors. Many of the errors were due to staff miscoding the surplus lines transactions in Sagitta and were not showing up on the report from which the monthly reports were prepared.

Recommendations: It is recommended that Parker, Smith & Feek Inc institute new procedures to include a second individual reviewing the monthly reports for accuracy since the process is so manual. It is further recommended to implement a new procedure to run a report of all surplus

lines transactions for a given month to determine if any coding errors took place. This may take some trial and error to find the right type of report but it should be done at least once a month to correct the coding before the monthly report needs to be filed. In addition, Parker, Smith & Feek Inc may want to investigate other software programs that include the creation of the report of surplus lines transaction form and monthly premium report summaries to further reduce the manual filling in of the reports. These recommendations should reduce the number of human errors on the monthly reports.

Parker, Smith & Feek Inc Response to initial exception report 1/31/07: Parker, Smith & Feek, Inc. has implemented a new procedure which requires a 2nd person to review each monthly, quarterly and annual report. We are also in the process of reviewing and changing our procedure on running monthly reports. This should eliminate any coding error and subsequent billing discrepancies resulting in incorrect tax and filing reports.

A new written procedure has been adopted showing that the full annual premium has to be reported at inception date of coverage, including the full annual tax and fee due to the State of Alaska. This specifically addresses policies invoiced on an installment basis.

Division of Insurance response: The corrected forms were included with the response to the exception report.

4. Verify the multi-state placements are filed correctly

AS 21.34.180

Comments: The broker has one client with a small location in Washington, which is included in two of the policies audited. The entire portion of the risk was reported in Alaska with none in Washington. The broker will need to follow up with WA to get this reported and then request a refund from Alaska for the erroneously paid taxes and fees. Tax and fees due to the insured for the two policies are \$27.48 and \$5.49 respectively for a total refund due the insured of \$32.97.

The incorrect premium error affects three other tests in the audit:

1. Accuracy of the monthly report
2. Accuracy of the quarterly and annual tax reports
3. Accuracy of the premium tax and filing fee payments.

Result: Passed (47 files passed & 2 failed, error rate 4%)

Recommendations: It is recommended that Parker, Smith & Feek Inc create written procedures for how they will allocate surplus lines risk between States. A portion of the risk for these two policies needs to be reported to the Washington State Office of the Insurance Commissioner. This may take contacting the insurance company for help to allocate the premium between the two States. A subsequent corrected monthly filing will be necessary with Alaska with a request for a refund of the taxes and fees allocated to WA.

Parker, Smith & Feek Inc Response to initial exception report 1/31/07: A written procedure has been established to allocate surplus lines taxes for multi state exposures. The error on the

insured has been corrected by contacting the insurance carrier and obtaining a premium breakdown by each State. The billings and filings have been revised and made according to Alaska Surplus Lines Filing Laws. Attached is our premium allocation and request for refund of the Alaska taxes and fees incorrectly paid. Copies of the corrected monthly filings are also attached. The appropriate premium, surplus lines tax and filing fees are currently being processed and will be paid to the State of Washington.

Division of Insurance response: The corrected forms and request for refund were included with the response to the exception report. Subsequent to the audit, the division created a new multi-state allocation form to use when a multi-state risk is placed in the surplus lines market.

5. Verify quarterly and annual premium tax reports were filed in a timely manner
AS 21.34.180, 3 AAC 21

Comments: All eight tax reports were filed timely with the division.

Result: Passed (error rate 0%)

6. Verify the accuracy of the quarterly and annual premium tax reports
AS 21.34.180, 3 AAC 21

Comments: Six policy files had errors affecting the tax reports originating from inaccurate premium calculations or inaccurate monthly reports. There are no additional errors to the tax reports for these errors because had the initial errors not been made, the tax reports would be accurate. However, the third quarter 2004 tax report and the 2004 annual premium tax report both had errors that were independent from the errors found in the audit files. The third quarter 2004 tax report should have included the tax amount for a policy that was reported correctly in the September 2004 monthly report but failed to make the tax report. The 2004 annual premium tax report was modified from the form created by the State of Alaska to include credits taken against tax. In addition, the quarterly premium tax payments as listed on the tax report did not match the actual payments made. This caused some confusion as to what was actually paid for the 2004 tax year. During the audit, a reconciliation was completed and no additional tax or fees are due other than those found for other audit errors.

The incorrect tax reports affected one other test in the audit:

1. Accuracy of the premium tax and filing fee payments.

Result: Failed (6 tax reports passed & 2 failed, error rate 25%)

Observations: The manual process created by Parker, Smith & Feek Inc for report completion is prone to errors.

Recommendations: It is recommended that Parker, Smith & Feek Inc create written procedures to ensure all taxes and fees are correctly accounted for on the quarterly and annual premium tax reports. It is further recommended that procedures be instituted to include a second

individual reviewing the tax reports for accuracy before filing with the State. Include in the procedures to not change the reports the State creates.

Parker, Smith & Feek Inc Response to initial exception report 1/31/07: Parker, Smith & Feek, Inc. has implemented a new procedure which requires a 2nd person to review each monthly, quarterly, and annual report. This procedure also specifies that we cannot make changes to the reports created by the State of Alaska.

7. Verify if tax and filing fee payments were made timely and by ACH

AS 21.34.180, 3 AAC 21

Comments: Two payments out of eight were made late. Late payment penalties were assessed and collected prior to the audit. All payments were made correctly by ACH.

Result: Failed (6 tax payments passed & 2 failed, error rate 25%)

Recommendations: It is recommended that Parker, Smith & Feek Inc create written procedures for processing all Alaska premium tax and filing fee payments to ensure the payment is initiated no later than 4:00pm Eastern Standard Time the business day prior to the due date. A best practice would be to not wait until the last minute to initiate a payment as connections to the Internet to access the ACH Debit program may not be available and there are times when the Alaska Division of Insurance servers are temporarily down. The ACH Debit program allows a payment to be warehoused or initiated up to 30 days prior to an effective date.

Parker, Smith & Feek Inc Response to initial exception report 1/31/07: Late payments of above report are due to an error by Parker, Smith & Feek, Inc. A new procedure has been implemented with our accounting department to eliminate late payment of future reports. Suspense is set up a week prior to the due date for communication between both offices in order to review the report to ensure accurate and timely payment to the State of AK.

8. Verify tax and filing fees payments were made accurately

AS 21.34.180, 3 AAC 21

Comments: The payments were made accurately based upon the tax reports as filed. During the audit, several filings were found to be inaccurate. Had the monthly reports, premiums and tax reports been accurate, the corresponding tax and fee payments would have been accurate. The only reason the payments were not accurate is the audit findings. Therefore, the tax and filing fee payments are considered accurate. However, there is additional tax and filing fee due of \$71.12 and \$1,358.66 respectively for a total of \$1,429.78.

Results: Passed (error rate 0%)

Observations: Parker, Smith & Feek, Inc consistently ensures all their tax and filing fee payments match the quarterly and annual premium tax reports as filed.

9. Review effort made to place insured with an admitted insurer

Comments: All files included the required affidavit of due diligence form. As of 6/11/06, this form is no longer a required document by regulation; however, the due diligence is still required by statute but can be documented in a variety of ways. If the broker wants to continue to require the use of this form, that is their prerogative.

Result: Passed (error rate 0%)

10. Review disclosures for use of non-admitted insurer

AS 21.34.100 and .110

Comments: The broker is using outdated stamps on evidence of insurance for AS 21.34.100. In addition, the broker name and license number must be on every evidence of insurance. In contrast, the language for AS 21.34.110 is exactly spelled out in the proposal given to the insured prior to binding. They also include this language in a letter after the placement was made asking for the insured to sign the letter and again at the time the policy was sent to the insured.

Result: Failed (6 files passed & 43 failed, error rate 88%)

Recommendation: It is recommended that Parker, Smith & Feek Inc update the written procedure manual to ensure that the new stamp ordered with the required language is used on all evidence of insurance as required by statute.

Parker, Smith & Feek Inc Response to initial exception report 1/31/07: New stamps with the correct notification as required by the Alaska Statute are being placed on each evidence of insurance. They also include our name and license number as directed.

11. Confirm coverage is placed with an eligible non-admitted insurer

AS 21.34.050

Comments: The broker is careful to use only surplus lines approved companies. Although in one file, the dec page showed an admitted company for 100% of the risk but the policy and all other evidence of insurance showed a surplus lines company as the insurance company for the insured. The wholesaler was contacted and they had made a mistake on the dec page and even though the policy has expired, they will be sending a corrected dec page with the right insurer.

Result: Passed (error rate 0%)

12. Review notice regarding nonrenewal and premium increase

3 AAC 25.050

Comments: Twenty seven files out of 49 did not have the required nonrenewal and premium increase notification as part of the policy.

Results: Failed (22 files passed & 27 failed, error rate 55%)

Recommendation: It is recommended that Parker, Smith & Feek Inc update the written procedure manual to ensure all required notifications are part of the policy. The insurer must be contacted when the notification is missing as this is a required notification to the insured.

Parker, Smith & Feek Inc Response to initial exception report 1/31/07: Everyone has been made aware of this requirement and we are incorporating it into our written policy review guideline worksheet.

Best Practices: Improper Disposal of Confidential Client Information

Comments: The auditor noted and it was confirmed by staff members at Parker, Smith & Feek Inc, that they recycle used paper in their active files. If careful attention is not paid, confidential client information may be disclosed in error. To further explain, some of this recycled paper contains confidential client information for an account not related to the file in which it has been placed.

Recommendation: It is recommended that Parker, Smith & Feek Inc discontinue the practice of recycling used paper in its active files and find other means of using the recycled paper.

Parker, Smith & Feek Inc Response to initial exception report 1/31/07: We no longer reuse paper.

SUMMARY AND SUBSEQUENT EVENTS

Summary

This was a premium tax audit of Parker, Smith & Feek Inc. The auditor tested 12 standards focusing on the broker's filing of monthly and annual tax reports and the subsequent payment of premium taxes and filing fees as well as due diligence and notification requirements for using a non admitted insurer.

The compliance officer and staff were very cooperative during the audit. The tax auditor appreciated this attitude and enjoyed working with Parker, Smith & Feek Inc's management and staff.

Several significant issues did arise during the audit.

- 1) Several of the required monthly reports were not accurately filled out which leads to inaccurate tax reports and inaccurate premium tax and filing fees payments. Once the root cause of the inaccuracies is fixed with the recommendations laid out by the auditor, the resulting inaccuracies should be corrected.
- 2) Several payments were not timely made leading to late payment penalties

3) The manual system in use by the broker is prone to errors.

Re-Audit

In closing, while the auditor found problems with the reports and payments, she also found that the broker wants to do things right. This is evident in the response to the exception report. The auditor's recommended actions, including those already implemented by the broker, should correct the problems encountered and it is recommended that Parker, Smith & Feek Inc be re-audited within the next three years to ascertain compliance with them.

Submitted by:
Rebecca Nesheim
Tax Auditor

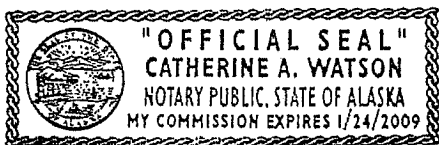
Parker, Smith & Feek Inc
As of December 31, 2005
TA 06-04

Juneau, Alaska)
April 25, 2007)
State of Alaska) ss.
First Judicial District)

I, being duly sworn, do verify that the report of premium tax audit as of December 31, 2005 of Parker, Smith & Feek Inc is true to the best of my knowledge and belief.

Rebecca Nesheim
Rebecca Nesheim
Tax Auditor

SUBSCRIBED and SWORN to before me this 25th day of April, 2007



[Signature]
Notary Public in and for Alaska
My Commission Expires 1/24/2009