

**Manual of Administrative Procedures**

**Chapter IX - Audit**

**A. Member Responsibilities**

Each Member is responsible to ensure that its own internal control and spot-check procedure is sufficient to detect any irregularity in handling all the Commonwealth Automobile Reinsurers' business. These controls include, but are not restricted to, the following items:

1. That all cessions, premiums, and claims are accurately and promptly reported to the Commonwealth Automobile Reinsurers;
2. That all reports, whether on a regular basis or by special call, are filed accurately and promptly;
3. That all producers are fully complying with the Plan of Operation and the Rules of Operation;
4. That ceded policies are properly rated and ceded claims properly reported to the Commonwealth Automobile Reinsurers.

If any internal irregularities are noted, they should be immediately corrected. Similarly, if, in the course of doing business, irregularities on the part of the Commonwealth Automobile Reinsurers or other Members are detected, these irregularities should be immediately reported to the Audit Committee. Each Member and producer is subject to audit by the Audit Committee or its designate to ensure compliance with the Commonwealth Automobile Reinsurers' procedures. Members are required to maintain records for policies and claims ceded to the Commonwealth Automobile Reinsurers for at least three calendar years following the last calendar year in which there has been activity.

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**B. Commonwealth Automobile Reinsurers' Procedures**

1. Internal Procedures

The Commonwealth Automobile Reinsurers shall maintain records of all Members' errors or violations of the Plan of Operation or the Rules of Operation. If these errors or violations are serious or voluminous for a particular Member, a report shall be made to the Audit Committee.

The Commonwealth Automobile Reinsurers' Management will obtain any other available information requested by the Audit Committee.

2. Staffing

The Commonwealth Automobile Reinsurers shall maintain adequate audit staff qualified to analyze the preceding information and to act as a Commonwealth Automobile Reinsurers' quality control representative.

The Commonwealth Automobile Reinsurers' audit staff shall consist of appropriate professional and clerical personnel required to carry out the audit objectives. Direct supervision of the audit staff will be the responsibility of the Commonwealth Automobile Reinsurers' Auditor. The Commonwealth Automobile Reinsurers' Auditor will report audit activities and the results of these analyses at each Audit Committee meeting. The audit staff, as need arises and at the discretion of the Audit Committee, may be required to conduct field audits at Members' offices.

3. Internal Commonwealth Automobile Reinsurers' Audits

The Commonwealth Automobile Reinsurers will be subject to continued quality control reviews by the audit staff. An independent audit will be conducted annually by a public accounting firm recommended by the Audit Committee and approved by the Governing Committee. This audit will include but will not be restricted to the procedures employed by the Commonwealth Automobile Reinsurers for the following:

- a. Expense allocation;
- b. Assessment formulas;

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**B. Commonwealth Automobile Reinsurers' Procedures (continued)**

3. Internal Commonwealth Automobile Reinsurers' Audits (continued)
  - c. Distribution of premium, or charges for losses, to the Members;
  - d. Investment of excess funds.

At the conclusion of this audit, the audit report and certified financial statements will be presented to the Audit Committee. Copies of the financial statement will be made available to Members upon request.

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**C. Audits of Servicing Carriers' Files**

When audits are conducted, an exact copy of all pertinent information contained in the underwriting and claim files will be accepted in lieu of the original record.

1. Documentation

The documentation for these audits shall include but will not be limited to the following:

- a. Photostats of declarations and endorsements for premium determinations;

In the absence of originals or photostats of originals, the following may be substituted:

- 1) A print-out of data stored in a computer, provided it is essentially in the same format as the declaration sheet, indicating coverages, limits, deductibles, dollars, etc., or
- 2) A hard copy of declaration and endorsement sheets produced from a microfiche, provided it is essentially in the same format as the declaration sheet, indicating coverages, limits, deductibles, dollars, etc.

The microfiche itself, or a duplicate thereof, will not be acceptable documentation for Field Audits.

- b. Claim file details;
- c. Salvage/subrogation recovery records;
- d. Reserve folder data;
- e. Commission rates applicable to all ceded risks;
- f. Dividend rates applicable to the Commonwealth Automobile Reinsurers' cessions.

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**C. Audits of Servicing Carriers' Files (continued)**

2. Field Audits and Other Audits

Field Audits and other audits of the Commonwealth Automobile Reinsurers' Members may be performed by the Commonwealth Automobile Reinsurers' Audit Department on those policies, records, books of account, documents, and related material as prescribed by the Commonwealth Automobile Reinsurers to carry out its functions, as authorized by Article VIII - Auditing of Members of the Plan of Operation.

Rule 9 - Audit Review of the Rules of Operation provides that there shall be a review and audit function prescribed by the Governing Committee.

3. Audit Reports

Upon completion of any audit review, a report will be submitted. A reply to the audit staff will be required within thirty days. If the results of the audit require input to the Commonwealth Automobile Reinsurers, the reply must state the accounting report which will reflect the necessary changes. The audit staff will report on all audits to the Audit Committee. Any unresolved conditions shall then be referred to the Governing Committee.

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**D. Review of Ceded Business**

Business reinsured with the Commonwealth Automobile Reinsurers shall be subject to audit to determine that procedures established by the Plan of Operation and the Rules of Operation have been complied with and that policies that have been reinsured are receiving the same service as those which are not reinsured. Any violation shall be reported with supporting information to the Governing Committee for appropriate action.

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**E. Rating Verification**

It is imperative that all ceded business be correctly classified and rated to insure that the Commonwealth Automobile Reinsurers receives the full and proper premium for the risk. Each Servicing Carrier licensed to write motor vehicle insurance or any component thereof shall permit access to its exposures and premiums for all ceded business. The Commonwealth Automobile Reinsurers may review at any time a Servicing Carrier's ceded policy files either in the Servicing Carrier's office or at the Commonwealth Automobile Reinsurers.

This information will be summarized and analyzed by the Commonwealth Automobile Reinsurers. If this analysis discloses any unusual patterns or trends, the Servicing Carrier will be required to explain the cause. The Servicing Carrier shall respond within thirty days stating if the Servicing Carrier concurs with the finding and will identify which accounting report, CAR Monthly Accounting Summary Report, will reflect the correct premium. If a reply is not received or is not responsive, the entire file will be made available to the Audit Committee for evaluation. The Audit Committee will consider referral of the case to the Governing Committee.

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**F. Claim Fidelity**

1. Statistical Reviews

Computer analysis of in-house data is to be used to determine direction of field audit examinations, audit frequency, and audit scope. Statistical comparisons, trends, and relative percentages of company and industry premium and loss figures which detect any adverse trends shall be thoroughly investigated.

The claim staff, Claims Advisory Committee, the audit staff, and the Audit Committee shall coordinate efforts and exchange information. If these reviews indicate any irregularities, appropriate action will be taken.

2. Loss Accounting Review

Claim file details, salvage/subrogation recovery records and reserve folder data shall be reviewed to verify reported amounts are in agreement with the Commonwealth Automobile Reinsurers' Plan of Operation, policy coverages, and dollar amounts reported to the Commonwealth Automobile Reinsurers. The Servicing Carrier will reflect the necessary change.

3. Servicing Carrier Confirmation Activity

Servicing Carriers shall obtain claimant confirmation on a reasonably representative number of claim payments on Commonwealth Automobile Reinsurers' ceded business. The extent of this confirmation activity will be reported to the Commonwealth Automobile Reinsurers upon written request. These reports, at the option of the Servicing Carriers, may include all confirmation activity or only that related to the Commonwealth Automobile Reinsurers' business.

4. Commonwealth Automobile Reinsurers' Confirmation Activity

The Commonwealth Automobile Reinsurers may confirm with the payee claim payments made on ceded business. Accidents may be confirmed with the insured. These inquiries will be made by either the public accounting firm referred to in Section B, Part 3 above, or by some other independent firm, and will be made in a manner which assures that the insureds are not informed of the fact that their policies have been reinsured in the Commonwealth Automobile Reinsurers under Article II of the Plan.

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**F. Claim Fidelity** (continued)

5. Claim Service

Each Servicing Carrier shall take all steps necessary to assure that its claim adjusters are not informed that any policy has been reinsured in the Commonwealth Automobile Reinsurers. This rule will be subject to verification at the time of claims review or audit review by the Commonwealth Automobile Reinsurers' staff.

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**G. Input Verification**

When a Servicing Carrier concurs with the exceptions noted in an audit report, this report will be distributed to the appropriate Commonwealth Automobile Reinsurers' staff areas which will be responsible to verify corrections are made and subsequent input complies with the Rules of Operation.

All information submitted by Servicing Carriers according to all Commonwealth Automobile Reinsurers' requirements is subject to verification by the Audit Committee or its designate.

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