LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION A COMPONENT UNIT OF THE STATE OF LOUISIANA

FINANCIAL STATEMENT AUDIT
FOR THE YEAR ENDED DECEMBER 31, 2008
ISSUED JANUARY 20, 2010

LEGISLATIVE AUDITOR
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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA

December 24, 2009

Independent Auditor's Report
on the Financial Statements

BOARD OF GOVERNORS OF THE
LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA
Metairie, Louisiana

We were authorized to audit the accompanying financial statements of business-type activities of the Louisiana Citizens Property Insurance Corporation (Citizens), a component unit of the State of Louisiana, as of and for the year ended December 31, 2008, which comprise Citizens' basic financial statements as listed in the table of contents. These financial statements are the responsibility of Citizens' management.

As discussed in Exhibits A and B, Citizens' internal controls, information systems, and accounting records contained major inadequacies. The inadequacies in user access controls and other weaknesses in its computer systems, the lack of monitoring of the activities of Citizens and its service providers, the deficiencies in Citizens' processes to develop loss liabilities, receivables, and other financial statement information, and other matters as further discussed in Exhibits A and B collectively do not provide adequate safeguards over Citizens' assets or ensure the proper recording of transactions. These inadequacies made it impractical to apply sufficient auditing procedures to enable us to express an opinion on the fair presentation of the financial statements.

Because we are not able to apply sufficient auditing procedures to satisfy ourselves as to the amounts included in the basic financial statements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements.

As discussed in notes 12, 16, and 17 to the financial statements, during August and September 2005, the State of Louisiana suffered considerable damage from two major hurricanes, Katrina and Rita, resulting in the President of the United States declaring Louisiana a major disaster area. Class action lawsuits have been filed against Citizens related to these events. Because of the severity of these events and the resulting damages sustained by the state, it is unknown exactly what economic impact recovery efforts will have on state and local government operations. Louisiana Revised Statute 22:2307 provides Citizens with a process to alleviate its deficits through regular and emergency assessments. In addition, Citizens issued revenue bonds in April 2006 to help address the losses caused by these catastrophic events. The long-term effects of theses events on Citizens and the state cannot be determined at this time.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 24, 2009, on our consideration of Citizens' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 5 through 14 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of attempting to form an opinion on the accompanying basic financial statements of the Louisiana Citizens Property Insurance Corporation taken as a whole. The accompanying supplemental information schedules, identified in the Table of Contents, are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The supplemental information schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements. For reasons previously stated in the second and third paragraphs of this report, we do not express an opinion on the basic financial statements. Similarly, we do not express an opinion on the supplementary information schedules.

Respectfully submitted,

Daryl G. Purpera

Daryl G. Purpera, CPA
Temporary Legislative Auditor

DSG:ES:EFS:PEP:dl

LCPIC09

Company Background

This discussion provides an assessment by management of the financial position, results of operations, cash flow and liquidity for Louisiana Citizens Property Insurance Corporation (LCPIC). LCPIC was established in 2003 by the Louisiana Legislature as a nonprofit corporation to operate residual market insurance plans effective January 1, 2004. The objective of LCPIC is to provide essential property insurance for residential and commercial property applicants who are unable to procure insurance through the voluntary market. LCPIC is the successor to the program established by Act 424 of the 1992 Regular Legislative Session designated as the "Fair Access to Insurance Requirements Plan" or otherwise known as the Louisiana Joint Reinsurance Plan (FAIR Plan) and the Louisiana Insurance Underwriting Plan (Coastal Plan). Information presented in this discussion supplements LCPIC's 2008 Annual Financial Statements.

Major events occurring in 2008 for LCPIC were:

- LCPIC moved its data center to a new secured location in March 2008.
- Separation from Property Insurance Association of Louisiana in April 2008.
- New senior management team put in place.
- Decision to replace current policy and claim management system was made.
- LCPIC's financial statements for 2005, 2006, and 2007 were completed and audited with the 2008 financial statement filed on a timely basis.
- LCPIC completed two rounds of depopulation in 2008 transferring 40,000 policies (approximately 25% of total policies) and $8.4 billion of exposure to the private insurance market.
- Three catastrophe occurrences in 2008. Incurred losses from one hurricane, Hurricane Gustav, exceeding the Company's reinsurance retention. A breakdown of the 2008 catastrophe loss occurrences is as follows:

Storm Name	Date of Occurrence	Number of Reported Claims	Total Losses (millions)
Windstorm (Cat. #40)	05/13/08 - 05/15/08	517	$2.8
Hurricane Gustav	08/31/08 - 09/03/08	50,953	$332.6
Hurricane Ike	09/12/08 - 09/14/08	3,637	$12.6

Financial Position

LCPIC's financial position (GAAP Basis) at December 31 was as follows:

Balance Sheet (in thousands of dollars - 000)	2008	2007
ASSETS		
Current Assets:		
Cash	$23,053	$161,940
Reinsurance receivables, net	131,602	32,649
Receivable from claims settlement	15,000	
Emergency assessment receivables, net	20,065	16,540
Prepaid reinsurance premiums	10,305	
Reinsurance reinstatement coverage receivable	7,714	
Other current assets	33,692	35,330
Total Current Assets	241,431	246,459
Noncurrent Assets:		
Restricted assets with bond trustee	190,307	332,330
Bond issuance costs, net	21,294	22,671
Capital assets, net of accumulated depreciation	5,161	7,833
Total Noncurrent Assets	216,762	362,834
Total Assets	$458,193	$609,293
LIABILITIES		
Current Liabilities:		
Unpaid loss and loss adjustment expenses	$251,891	$405,039
Unearned premiums	112,382	136,008
Special assessments revenue bonds	48,150	
Reinsurance premiums payable	8,238	
Other current liabilities	26,043	24,454
Total Current Liabilities	446,704	565,501
Noncurrent Liabilities:		
Special assessments revenue bonds	955,417	1,006,677
Total Noncurrent Liabilities	955,417	1,006,677
Total Liabilities	1,402,121	1,572,178
NET ASSETS		
Invested in capital assets, net of related debt	5,161	7,833
Restricted for debt service	74,322	34,811
Unrestricted	(1,023,411)	(1,005,529)
Total Net Assets	($943,928)	($962,885)

Assets

Total assets decreased by $151.1 million (25%) primarily because of cash used to pay claims for catastrophe related losses, principally for hurricanes Gustav and Katrina as noted below.

LCPIC's cash balances decreased in 2008 by $138.9 million as a result of the payments for catastrophe related losses and expenses exceeding premiums collected. The payments (in millions) for 2008 by catastrophic event are as follows:

Catastrophe Description	Date of Loss	Paid Losses (millions)
Hurricane Gustav	08/31/08 - 09/03/08	$253.6
Hurricane Katrina	08/25/05 - 08/29/05	$103.1
Hurricane Rita	09/20/05 - 09/24/05	$13.1
Hurricane Ike	09/12/08 - 09/14/08	$10.4
Windstorm (Cat #40)	05/13/08 - 05/15/08	$2.6
Total Paid Losses		$382.8

Amounts receivable from reinsurers increased by $99.0 million as Hurricane Gustav losses exceeded LCPIC's retention of its Property Catastrophe Excess of Loss Reinsurance Contract during the latter part of the 4th Quarter. A receivable was recorded in the amount of $7.7 million as of year-end for the return of reinstatement premium which is offset by the payable owed to the reinsurers under the primary reinsurance contract.

A settlement was reached in connection with a Hurricane Katrina/Hurricane Rita bad faith class action suit. LCPIC issued payment to a court trustee for the maximum judgment of $35.0 million in November 2008. Further analysis by the class action attorneys determined that the actual payout would be no more than $20.0 million, with the remaining funds to be paid back to LCPIC. Based upon the developments noted above, LCPIC accrued a $15.0 million receivable at December 31, 2008.

The receivable for the emergency assessment from insurers of the voluntary market increased $3.5 million (21%) as compared to 2007. This growth is due to the increase in the assessment rate applied to the insurers' direct written premiums of 5.0% in 2008 as compared to 3.6% in 2007.

A reinsurance premium installment of $10.3 million was due on January 1, 2009, which was a banking holiday. LCPIC elected to pay the installment on December 31, 2008.

The funds that comprise restricted assets with bond trustee are entirely related to the assessment revenue bond obligations issued in 2006 to pay the Hurricane Katrina losses. These assets are money market securities and repurchase agreement securities, both held by the bond custodian, Regions Bank. The restricted assets held by the bond trustee decreased by $142.0 million in 2008, primarily because of a drawdown of the loan proceeds made by LCPIC to offset cash payments of Katrina losses.

Liabilities

Total liabilities decreased by $170.1 million (11%) primarily because of the $153.1 million reduction in unpaid loss and loss adjustment expenses as described below.

Unpaid losses and loss adjustment expenses are stated as LCPIC's estimate of the ultimate cost, excluding reinsurance, of settling all incurred but unpaid claims. Unpaid losses and loss adjustment expenses are not discounted and no estimate for salvage and subrogation is applied as a reduction to the unpaid losses. The estimate for unpaid losses and loss adjustment expenses is closely monitored and adjusted for changes in economic, social, judicial, and legislative conditions, as well as historical trends. LCPIC uses various development modeling techniques to assist in the evaluation of its reserves under the direction of its chief actuary.

Management believes that the loss reserves are adequate, but establishing reserves is a judgmental and inherently uncertain process. It is therefore possible that as conditions and experience develops, reserve adjustments may be required in the future.

Activity with respect to unpaid losses and loss adjustment expenses (LAE) for the last two years is displayed below:

Losses and LAE (000)	2008	2007
Unpaid losses and LAE at beginning of year	$405,039	$581,133
Losses and LAE incurred in current year:		
For current year losses and LAE	417,220	78,463
For prior year losses and defense and cost containment expenses	(84,637)	(26,317)
For prior year adjusting and other expenses	(33,300)	17,426
Current year service provider fees payable	6,549	19,094
Income statement amounts	305,832	88,666
Losses and LAE paid in current year:		
For current year losses and LAE	(314,400)	(42,247)
For prior year losses and LAE	(144,580)	(222,513)
Underwriting exhibits paid amounts	(458,980)	(264,760)
Unpaid losses and LAE at end of year	$251,891	$405,039

LCPIC experienced favorable development of unpaid loss and LAE estimates. The 2005 accident year storms, hurricanes Katrina and Rita, were the principal drivers of this favorable development. The decrease in estimates for prior loss years of $117.9 million ($84,637 + $33,300) stated above is derived from the decrease in IBNR reserves for hurricanes Katrina and Rita.

Unearned premiums decreased $23.6 million (17%). The majority of this decrease is attributable to the ceded unearned premium stemming from LCPIC's depopulation program in 2008. LCPIC's depopulation program consisted of two separate rounds in which approximately 40,000 policies (approximately 25% of total policies) and $68.0 million in annualized premium were ceded to four companies that were a part of the State Incentive Program and three companies that participated outside of the State Incentive Program.

A current payable for the June 2009 bond principal payment of $48.1 million was recorded at December 31, 2008.

The $8.2 million payable for reinsurance premiums is primarily due to the reinstatement premium owed at December 31 under LCPIC's primary reinsurance coverage as a result of the losses incurred from Hurricane Gustav in 2008.

Net Assets

Total net assets increased by $19.0 million in 2008.

The primary reasons for the increase in total net assets were:

1. Emergency assessment income was greater than debt service costs on long-term debt obligations on assessment revenue bonds issued to offset the losses incurred by LCPIC for Hurricane Katrina.

2. Reduction of claim reserves, primarily those of hurricanes Katrina and Rita.

3. Offsetting these gains was a loss due to claims expenses to pay catastrophe related storms.

Results of Operations

LCPIC's operating results (GAAP Basis) are presented in the following table.

Statement of Revenues, Expenses, and Changes in Net Assets (000)	2008	2007
Operating Revenues:		
Total net premium earned	$191,827	$156,265
Finance and service charges	4,312	5,548
Interest income	3,576	7,474
Other operating revenues	36	118
Total Operating Revenues	199,751	169,405
Operating Expenses:		
Losses and loss adjustment expenses	196,277	70,878
Underwriting expenses	42,072	44,094
Total Operating Expenses	238,349	114,972
Operating Income (Loss)	(38,598)	54,433
Nonoperating Revenue (Expenses):		
Interest earned	(63,489)	(44,778)
Net investment income	7,201	16,134
Emergency assessment income	103,646	78,012
Market equalization charges	14	20,318
Excess regular assessment recoupments	1,712	13,794
Tax exempt surcharge	8,471	6,576
Total Nonoperating Revenues	57,555	90,056
Change in Net Assets	18,957	144,489
Net Assets at Beginning of Year (Restated)	(962,885)	(1,107,374)
Net Assets at End of Year	($943,928)	($962,885)

Although direct written premium increased 5% in 2008 versus 2007, net premiums earned grew $35.6 million (23%) because of the reduction in the liability for unearned premiums from 2007 to 2008. The premium growth in 2007 caused the unearned premium liability to increase at the end of 2007; therefore, a greater proportion of the premiums written in 2007 were earned in 2008.

The increase in incurred losses and loss adjustment expenses of $125.4 million (177%) is from the catastrophe loss occurrences in 2008. LCPIC total estimated losses and expenses from Hurricane Gustav are $332.6 million and $12.6 million from Hurricane Ike. The losses were offset by the reduction in incurred but not reported (IBNR) reserves of $47.6 million.

In 2008 interest costs increased $18.7 million for the $300.0 million variable rate bonds associated with LCPIC's bond program established in 2006. The deterioration of the financial markets in the latter half of 2008 increased the interest cost of the variable rate bonds. LCPIC converted the variable rate bonds to fixed rate bonds in 2009.

The $25.6 million increase in emergency assessment income was primarily due to the assessment rate increase of 5.0% in 2008 as compared to 3.6% in 2007.

Market equalization charges decreased $20.3 million due to phasing out this fee income applicable to LCPIC's policies. The market equalization fees were established by assessing all policies with effective dates beginning mid-year 2006 and were assessed on all policies with an effective date during the following 12-month period.

Cash Flow and Liquidity

Cash Flow

Sources of cash include proceeds from premiums and emergency assessments collected and amounts received from restricted investments and primary uses of cash include cash used in operations and interest paid on debt.

Cash flow from operations decreased by $261.8 million in 2008, compared to 2007.

The premiums collected decreased $28.4 million (14%) for 2008. Although LCPIC experienced an increase in total net premiums earned, as described earlier, this increase was primarily driven by changes in unearned premium rather than by premiums collected. The premiums collected are lower because LCPIC ceded premiums for the depopulation program in 2008.

The losses paid increased $165.7 million (72%) because of hurricanes Gustav and Ike which occurred in 2008 and hurricanes Katrina and Rita which occurred in 2005. The amounts paid in 2008 for these storms were in excess of $382.8 million as noted in the Assets section. Catastrophe loss payments accounted for 84% of the total loss payments, while noncatastrophe related losses were only 16% of the total losses paid in 2008.

Expenses paid increased by $62.5 million (123%) in 2008 as compared to 2007. This increase was driven by claim settlement costs associated with hurricane related claims. In 2007, LCPIC's state premium tax payments were held until a determination of LCPIC's premium tax status was made. In 2008, the Louisiana Insurance Department determined that LCPIC is subject to state premium taxes; therefore, LCPIC paid $3.0 million of premium taxes which included $1.5 million for prior years. In 2008, LCPIC paid $3.0 million for consulting work for programming and maintenance of its policy/claim system and to reconcile bank accounts from October of 2005.

Emergency assessment income received increased by $35.5 million (58%) because of the assessment rate increase of 5.0% in 2008 as compared to 3.6% in 2007.

The market equalization charge income decreased in 2008 by $20.3 as compared to 2007. The market equalization charge income is a surcharge which the governing board of LCPIC is authorized to levy on all plan policies to place LCPIC's policyholders on equal standing with the policyholders in the voluntary market during the period in which regular assessments are being assessed by LCPIC. The majority of this increase was earned in 2007.

Interest paid on debt increased in 2008 because of higher interest cost paid on the $300.0 million variable rate securities associated with bond debt.

Amounts received from restricted investments with bond trustee reflect the cash withdrawn by LCPIC to offset cash outlay of Katrina losses.

Liquidity

All liquid funds held by LCPIC are kept in interest-bearing commercial bank accounts that are 100% collateralized. Although LCPIC's liquidity was impacted by hurricanes Gustav and Ike in the fall of 2008 and Hurricane Katrina claim settlement payments, LCPIC was able to manage a $250 million catastrophe event without initiating an assessment to the voluntary marketplace.

In 2005, LCPIC did not have sufficient funds to pay 80,000 claims resulting from hurricanes Katrina and Rita. LCPIC borrowed $978.2 million, of which $678.2 million is fixed rate bonds and $300.0 million is variable auction rate bonds. The debt service of these bonds is paid through emergency assessments on property insurance policies written in the State of Louisiana. The emergency assessments are remitted quarterly to the bond trustee. The ongoing turmoil in the auction rate market caused the variable rate bonds to auction at much higher rates than originally anticipated. Developing a plan to restructure the variable rate bonds was a major priority of LCPIC's management in 2008.

In addition to policyholder premiums, LCPIC has much broader range of resources available to pay losses and repay debt obligations than does a typical insurer. LCPIC can institute a regular assessment on the state insurance industry of up to 10% for deficits each year, and an emergency assessment of up to 10% on property owners of the State of Louisiana up to 10% per storm event to pay debt incurred for storms such as hurricanes Katrina and Rita. No line of credit is currently maintained for catastrophe losses and general corporate purposes; however, LCPIC uses reinsurance to mitigate the possibility of assessments.

Pending Litigation

There are approximately 1,926 open litigation matters against LCPIC. Approximately 85% to 90% are first-party suits related to hurricanes Katrina and Rita.

The balance of the litigated actions are related to fire losses, third-party bodily injury claims, subrogation matters or examinations under oath of insureds with questionable coverage claims.

LCPIC is also a defendant in three class action suits resulting from hurricanes Katrina and Rita:

- *Press v. Louisiana Citizens Property Insurance Corporation*. The plaintiffs in this suit allege that approximately 25% (19,250) adjusted Katrina and Rita claims did not include payments for overhead and profit. This matter was certified in July 2008 and an appeal of the certification is currently pending in the 4th District of the Louisiana Court of Appeals. If the appeal is denied by the 4th District, LCPIC will also be taking writs to the Supreme Court of Louisiana. Until the question of certification is finally decided by the appellate courts, it is difficult to determine LCPIC's potential exposure with any certainty. However, LCPIC does not anticipate a significant judgment in this matter.

- *Thibodeaux v. Louisiana Citizens Property Insurance Corporation*. The plaintiffs in this suit allege that LCPIC failed to include the $65.00 application fee on its declaration page for all new policies. Plaintiffs seek return of the $65.00 fee for all affected policyholders. This matter was certified as a class action by the court on February 17, 2009, and LCPIC will be appealing this order to the 1st Circuit Court of Appeals on or before March 15, 2009. Again, if the appeal is denied by the 1st Circuit, LCPIC will be taking writs to the Supreme Court of Louisiana. In addition to the issues related to certification, there are a number of legal issues related to the merits that will need to be addressed by the court. The resolution of any of these issues could result in this case being dismissed as a whole. Once again, it is difficult to assess the potential exposure of this matter until such time as the certification issue is finally decided by the appellate courts. However, LCPIC does not anticipate a significant judgment in this matter.

- *Oubre v. Louisiana Citizens Property Insurance Corporation*. The plaintiffs in this suit allege that LCPIC failed to timely initiate loss adjustment as required by Louisiana statutory law, thus exposing LCPIC to mandatory penalties in the amount of $5,000.00. This matter was certified as a class action and is set for trial to take place on March 23, 2009. Class certification has been upheld by the Court of Appeal. Motions for summary judgment seeking an award are currently pending and awaiting trial court ruling. The class is alleged to consist of approximately 60,000 members. LCPIC has filed cross motions for summary judgment seeking the dismissal of this matter which are also pending before the trial court. LCPIC anticipates a significant judgment in this matter from the trial court, but believes the Court of Appeal will provide relief from the anticipated judgment from the trial court.

These actions are being vigorously defended by nine outside law firms. Based upon the reports provided by counsel regarding these suits, LCPIC does not anticipate any significant judgments.

Future Plans

LCPIC had $300.0 million in variable rate bonds outstanding that were trading at higher than anticipated rates. In early 2009, LCPIC successfully converted the variable rate bonds to fixed rate bonds and locked in lower interest rates for the life of the bonds.

LCPIC had an excess of loss catastrophe reinsurance program that provided coverage for 90% of $500 million after a $200 million retention that expired on June 1, 2009. LCPIC successfully negotiated a new reinsurance program with limits of 95% of $400 million after a $100 million retention for the 2009 storm season.

As a result of multiple issues, LCPIC's policy and claim management system was reviewed and a decision was made to purchase a new policy management system. An RFP was prepared and released in the spring of 2008 and a contract for a new policy and claim management system was awarded in the first quarter of 2009. LCPIC is currently establishing processes to implement the new system and retire the existing policy and claim management system.

To the extent that the above comments about future plans constitute forward-looking statements, these statements are not guarantees of future performance. Forward-looking statements are based on current expectations and projections about future events and are subject to risks, uncertainties, and assumptions about LCPIC, economic and market factors, judicial rulings and the insurance industry, among other things. Actual events may differ materially from those expressed in forward-looking statements.

Statement A

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA

Statement of Net Assets, December 31, 2008

ASSETS	
Current assets:	
Cash and cash equivalents (note 3)	$16,383,669
Cash restricted to satisfy restricted liabilities (note 3)	6,668,920
Interest and dividends receivable	4,933
Premium receivables and agent's balances, net (note 1-E)	22,400,107
Reinsurance receivables, net	131,602,048
Deferred policy acquisition cost	11,238,178
Receivable from claim settlement	15,000,000
Emergency assessments receivables, net (note 4)	20,065,414
Prepaid reinsurance premiums	10,305,419
Other current assets	7,762,410
Total current assets	241,431,098
Noncurrent assets:	
Restricted investments with bond trustee (note 3)	190,307,224
Bond issuance costs, net	21,294,394
Capital assets, net of accumulated depreciation (note 5)	5,161,302
Total noncurrent assets	216,762,920
Total assets	458,194,018
LIABILITIES	
Current liabilities:	
Unpaid losses and loss adjustment expenses	251,891,269
Unearned premiums	112,381,832
Advance premiums	6,646,491
Unearned tax exempt surcharge	4,009,978
Commissions payable to agents, net	4,222,599
Accrued expenses, taxes, licenses, and fees	4,086,720
Accrued bond interest payable	4,849,043
Take-out program	2,152,811
Special assessment revenue bonds (note 12)	48,150,000
Other current liabilities	8,313,816
Total current liabilities	446,704,559
Noncurrent liabilities -	
special assessment revenue bonds (note 12)	955,416,675
Total liabilities	1,402,121,234
NET ASSETS	
Invested in capital assets, net of related debt	5,161,302
Restricted for debt service (note 8)	74,322,314
Unrestricted	(1,023,410,832)
Total net assets (note 2)	($943,927,216)

The accompanying notes are an integral part of this statement.

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Statement B

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA

Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended December 31, 2008

OPERATING REVENUES	
Premiums:	
Premiums earned	$284,961,037
Premiums ceded	(93,134,377)
Total net premiums earned (note 7)	191,826,660
Finance and service charges	4,312,044
Interest income	3,576,067
Other	36,430
Total operating revenues	199,751,201
OPERATING EXPENSES	
Losses incurred and loss adjustment expenses	196,277,701
Underwriting expenses	42,071,796
Total operating expenses	238,349,497
Operating loss	(38,598,296)
NONOPERATING REVENUE (Expenses)	
Interest expense	(63,488,508)
Net investment income	7,201,233
Emergency assessment income (note 4)	103,646,244
Market equalization charges	14,030
Excess regular assessment recoupments (note 4)	1,712,073
Tax exempt surcharge	8,470,948
Total nonoperating revenue (expenses)	57,556,020
Increase in Net Assets	18,957,724
Net Assets at Beginning of Year, Restated (note 18)	(962,884,940)
Net Assets at End of Year	($943,927,216)

The accompanying notes are an integral part of this statement.

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Statement C

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA

Statement of Cash Flows
For the Year Ended December 31, 2008

CASH FLOWS FROM OPERATING ACTIVITIES	
Premiums collected	$170,153,160
Net investment income received	3,576,067
Finance and service charges	4,312,044
Other receipts	36,430
Losses paid	(396,773,375)
Loss adjustment expenses paid	(66,507,586)
Underwriting expenses paid	(46,981,653)
Net cash used by operating activities	(332,184,913)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Emergency assessments received	96,999,120
Regular assessments received	1,712,073
Market equalization charges received	14,030
Tax exempt surcharge received	8,400,680
Interest paid on debt	(63,730,722)
Net cash provided by noncapital financing activities	43,395,181
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES	
Purchases of capital assets	(37,733)
Net cash used by capital financing activities	(37,733)
CASH FLOWS FROM INVESTING ACTIVITIES	
Amounts received from restricted investments with bond trustee	142,023,205
Interest and dividends	7,917,268
Net cash provided by investing activities	149,940,473
Net decrease in cash and cash equivalents	(138,886,992)
Cash and cash equivalents, beginning of year	161,939,581
CASH AND CASH EQUIVALENTS, END OF YEAR	$23,052,589

(Continued)

The accompanying notes are an integral part of this statement.

Statement C

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA
Statement of Cash Flows
For the Year Ended December 31, 2008

RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES	
Operating loss	($38,598,296)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Depreciation expense	2,709,782
Changes in net assets and liabilities:	
Decrease (increase) in:	
Premiums receivable and agents' balances	(1,393,137)
Reinsurance receivables	(37,939,373)
Deferred policy acquisition costs	2,362,640
Receivable from claims settlement	(15,000,000)
Prepaid reinsurance premiums	(10,305,419)
Other current assets	(7,761,621)
Increase (decrease) in:	
Unpaid losses and loss adjustment expenses	(214,160,740)
Unearned premiums	(23,626,349)
Advance premiums	3,345,986
Commissions payable to agents	(358,166)
Accrued taxes, licenses, fees, and other expenses	(1,070,634)
Take-out program liabilities	2,152,811
Other current liabilities	7,457,603
Net cash used by operating activities	($332,184,913)

(Concluded)

The accompanying notes are an integral part of this statement.

INTRODUCTION

Louisiana Citizens Property Insurance Corporation (Citizens) was created in accordance with provisions of Louisiana Revised Statute (R.S.) 22:2293 to operate insurance plans which provide property insurance for residential and commercial property, solely for applicants who are in good faith entitled, but are unable, to procure insurance through the voluntary market. Citizens operates residual market insurance programs, throughout the State of Louisiana (the State), designated as the Coastal Plan (succeeded the Louisiana Insurance Underwriting Plan) and the Fair Access to Insurance Requirements Plan (FAIR Plan) (succeeded the Louisiana Joint Reinsurance Plan). The Coastal Plan is for property insurance written on locations between the Gulf of Mexico and the Intracoastal Waterway and the FAIR Plan is for property insurance above the Intracoastal Waterway.

Citizens began operations on January 1, 2004, with its headquarters and corporate offices located in Metairie, Louisiana. It is governed by a board of directors consisting of 15 members, who serve without compensation. The Board consists of the commissioner of the Department of Insurance, the state treasurer, the chairman of the House Committee on Insurance, the chairman of the Senate Committee on Insurance or their designees, six representatives appointed by the governor, two members appointed by the commissioner of the Department of Insurance, and three members appointed by the governor.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. REPORTING ENTITY

Governmental Accounting Standards Board (GASB) Codification Section 2100 has defined the governmental reporting entity to be the State of Louisiana. Citizens is considered a component unit of the State of Louisiana because the relationship with the state is such that the exclusion of Citizens' information from the State's financial statements would cause the State's financial statements to be incomplete or misleading. The accompanying financial statements present information only as to the transactions and programs of the Louisiana Citizens Property Insurance Corporation, a component unit of the State of Louisiana.

B. MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION

The financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Generally, private-sector standards of accounting and financial reporting issued prior to December 1, 1989, are followed in proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of GASB. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation.

C. USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make certain estimates and assumptions that directly affect the reported amounts of assets, liabilities, revenues, and expenses. Actual results may differ from those estimates.

The determination of the unpaid losses and unpaid loss adjustment expense amounts are particularly sensitive estimates subject to change.

D. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Citizens has defined cash and cash equivalents to include cash on hand and demand deposits. Under State law, Citizens may invest in U.S. bonds, treasury notes, or certificates. Citizens also may invest in direct repurchase agreements of any federal bank. The collateral for the agreement can only include securities as described above. Investments are stated at their fair value which approximates cost.

E. RECEIVABLES

Premium receivables and agents' balances are reported net of amounts estimated to be uncollectible. The amounts estimated to be uncollectible as of December 31, 2008, were $270,726 and are reported as a reduction in premiums earned in the accompanying financial statements.

F. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value of cash, receivables and accounts payable approximates fair value because of the short maturity of these instruments and obligations.

G. REINSURANCE

In the normal course of business, Citizens seeks to reduce the loss that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers. Amounts recoverable from reinsurers are estimated in a manner consistent with the reinsurance policy.

H. RECOGNITION OF PREMIUM REVENUES

Revenues from written premiums are recorded as unearned premiums and recognized when earned, on a straight-line basis, over the contract period. The tax exempt surcharge assessed on all written premiums is recognized consistently with the premium recognition policy.

I. UNPAID CLAIMS AND CLAIM ADJUSTMENT EXPENSES

The liability for losses and loss adjustment expenses includes an amount determined from loss reports and individual cases and an amount, based on past experience, for losses incurred but not reported. Such liabilities are necessarily based on estimates and while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments are reflected in current earnings. The reserves for losses and loss adjustment expenses are reported gross of estimated recoveries from reinsurance of approximately $76,227,692, which is included in the reinsurance receivable.

J. DEFERRED POLICY ACQUISITION COSTS

Commissions and other costs of acquiring insurance that are primarily related to the production of new and renewal business are deferred and amortized over the terms of the policies to which they relate. Amortization in 2008 was $17,912,901 and is reported within underwriting expenses in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets.

K. CAPITAL ASSETS

All acquisitions of property and equipment in excess of $5,000 whose useful lives extend beyond a one-year period are capitalized. Capital assets consist of electronic data processing and communication equipment. They are recorded at cost and depreciated using the straight-line method over the following useful lives:

Electronic data processing equipment	5 years
Communication and office equipment	10 years

Depreciation expense for 2008 totaled $2,709,782.

L. CONTINGENCIES

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to Citizens, but which will only be resolved when one or more future events occur or fail to occur. Citizens' management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against Citizens or unasserted claims that may result in such proceedings, Citizens' legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, the estimated liability would be accrued in Citizens' financial statements. If the assessment indicates that a potentially material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed. Loss contingencies considered remote are generally not disclosed unless they arise from guarantees in which case, the guarantees would be disclosed.

M. DEFINING OPERATING REVENUES AND EXPENSES

Citizens distinguishes between operating and nonoperating revenues and expenses. Operating revenues and expenses consist of charges for insurance policies and the costs of providing such policies. All other revenues and expenses are reported as nonoperating.

N. INCOME TAXES

Pursuant to Private Letter Ruling 160165-03 from the Internal Revenue Service, Citizens constitutes an integral part of the State of Louisiana and its income is exempt from federal income tax.

O. NET ASSETS

The net assets of Citizens are divided into three components:

1. Invested in capital assets, net of related debt consist of the historical cost of capital assets less accumulated depreciation and less any debt that remains outstanding that was used to finance those assets.

2. Restricted net assets consist of net assets that are restricted by Citizens' creditors (through debt covenants) or by the state enabling legislation (through restrictions on uses of revenues).

3. Unrestricted consists of all other net assets reported in this category.

2. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Deposits and Investment Laws and Regulations

In accordance with state law, all uninsured deposits of Citizens in financial institutions must be secured with acceptable collateral valued at the lower of cost or market or par. As of December 31, 2008, Citizens' cash and cash equivalents were entirely insured or collateralized with securities held by its agent in Citizens' name.

Deficiency in Net Assets

Citizens reported a deficiency in net assets of $943,927,216 at December 31, 2008, resulting primarily from losses on insured property caused by hurricanes Katrina and Rita during 2005. Citizens plans to eliminate the deficit through emergency assessments on affected insurance companies and policy holders.

3. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Citizen' cash and cash equivalents consist of the following at December 31, 2008:

	Carrying Amount	Bank Balance
Demand deposits	$23,052,589	$97,763,958

These deposits are stated at cost, which approximates market. Under state law, these deposits (or the resulting bank balances) must be secured by federal deposit insurance or the pledge of securities owned by the fiscal agent bank. The market value of the pledged securities plus the federal deposit insurance must at all times equal the amount on deposit with the fiscal agent. These securities are held in the name of the pledging fiscal agent bank in a holding or custodial bank that is mutually acceptable to both parties.

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a bank failure, Citizens' deposits may not be returned to it. As of December 31, 2008, a total of $97,513,958 of Citizens' bank balance was exposed to custodial credit risk. However, these deposits were secured by the pledge of securities owned by the fiscal agent bank.

At December 31, 2008, Citizens has investments of $190,307,224 which are detailed as follows:

Credit Risk

	Rating	Percentage
Treasury Obligation Mutual Fund	AAAm/Aaa	79%
Repurchase Agreement	Unrated	21%

Citizens does not have a formal investment policy regarding investment credit risk.

Custodial Credit Risk - Investments

For an investment, custodial credit risk is the risk that in the event of the failure of the counterparty, Citizens will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Citizens follows the investment criteria as defined by state statute. Of Citizens' $40,815,946 investment in a repurchase agreement, the entire amount was exposed to custodial credit risk. However, the investment is secured by the pledge of government-backed securities owned by the counterparty and held by a mutually acceptable custodian bank.

Concentration of Credit Risk

Citizens has no formal limit on the amount it may invest in any one issuer. By definition, Citizens' investment in the Treasury Obligation Mutual Fund is not considered a concentration of credit risk. However, Citizens has invested 21% of total investments in a repurchase agreement with a federal bank.

Interest Rate Risk

	Maturity	Fair Value
Repurchase Agreement	6/1/2026	$40,815,846

Citizens does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

4. ASSESSMENTS RECEIVABLE AND REVENUE

R.S. 2299-2300 provides that any insurer who engages in writing property insurance within Louisiana shall become an assessable insurer in the Coastal Plan and FAIR Plan. In the event that the governing board of Citizens determines that a deficit exists in either the Coastal Plan or the FAIR Plan, Citizens may levy regular assessments against assessable insurers for each affected plan to help offset such deficit. Furthermore, assessable insurers are permitted to recoup all regular assessments from their policyholders by applying a surcharge to all policies. Any amounts recouped by the insurers in excess of amounts assessed are required to be forwarded to Citizens.

During 2005, the governing board levied a 2005 regular assessment in an amount that equaled 10% for the FAIR Plan and 5% for the Coastal Plan, of the aggregate statewide direct written premium for the subject lines of business for the calendar year 2004. At December 31, 2008, there were no additional amounts owed to Citizens under the 2005 assessment, but excess recoupments received totaled $1,712,073. No regular assessments were levied during 2008.

Upon a determination by the governing board that a deficit in a plan exceeds the amount that will be recovered through regular assessments, the governing board is authorized to levy, after verification by the DOI, emergency assessments for as many years as necessary to cover the deficit. The board determined that the 2005 plan year deficit exceeded the amounts levied under the 2005 regular assessment and has levied an emergency assessment beginning in 2007 of 3.6% of written premium and has approved a levy of 5.0% for 2008 and 2009. The assessments are collected by the insurers and remitted to the Corporation's bond trustee quarterly. The total of 2008 emergency assessments levied amounted to $103,646,244 of which $20,065,414 remained outstanding as of December 31, 2008.

5. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2008, was as follows:

	Balance January 1, 2008	Increases	Decreases	Balance December 31, 2008
Capital Assets Being Depreciated:				
Electronic data processing equipment	$13,229,083	$37,733		$13,266,816
Communication and office equipment	611,586			611,586
Total Capital Assets Being Depreciated	13,840,669	37,733	NONE	13,878,402
Less Accumulated Depreciation for:				
Electronic data processing equipment	(5,911,302)	(2,645,817)		(8,557,119)
Communication and office equipment	(96,016)	(63,965)		(159,981)
Total Accumulated Depreciation	(6,007,318)	(2,709,782)	NONE	(8,717,100)
Total Capital Assets Being Depreciated, Net	$7,833,351	($2,672,049)	NONE	$5,161,302

6. RISK MANAGEMENT

Citizens has a geographic exposure to catastrophe losses in the areas where its policy holders' insured property resides. These catastrophes can be caused by various events, including hurricanes, windstorms, and hail, and the incidence and severity of catastrophes are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Most catastrophes are restricted to small geographic areas; however, hurricanes may produce significant damage in large, heavily populated areas. Citizens generally seeks to reduce its exposure to catastrophes through the purchase of catastrophe reinsurance.

7. REINSURANCE RECEIVABLE AND CONCENTRATIONS OF CREDIT RISK

Reinsurance contracts do not relieve Citizens from its obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to Citizens; consequently, allowances are established for amounts deemed uncollectible. Citizens evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

Citizens limits the maximum net loss that can arise from large risks or risks in concentrated areas of exposure by reinsuring (ceding) certain levels of risks with other insurers or reinsurers on an automatic basis under general reinsurance contracts known as treaties. Citizens acquired catastrophe reinsurance coverage of $400,000,000 per occurrence and $800,000,000 in the aggregate for combined losses in excess of $100,000,000 for the policy year beginning June 2007 and ending May 2008. The Corporation will bear a prorated risk of loss of 10% and the reinsurance carrier bears a prorated risk of loss of 90% of the reinsured losses. Beginning June 2008 and ending May 2009, the corporation purchased catastrophe reinsurance coverage of $500,000,000 per occurrence and $1,000,000,000 in the aggregate for combined losses in excess of $200,000,000. The corporation will bear a prorated risk of loss of 10% and the reinsurance carrier bears a prorated risk of loss of 90% of the reinsured losses. The Corporation would bear 100% of the risk for all losses in excess of the reinsurance contract limits for both contracts.

The effect of reinsurance on premiums written and earned is as follows:

	Written	Earned
Direct	$279,969,503	$284,961,037
Assumed	NONE	NONE
Ceded	(117,833,884)	(93,134,377)
	$162,135,619	$191,826,660

The amount of recoveries pertaining to reinsurance contracts that were deducted from losses incurred and loss adjustment expenses during 2008 was approximately $122,671,645.

8. RESTRICTED NET ASSETS

The Statement of Net Assets includes $74,322,314 of net assets restricted for the repayment of the Special Assessment Revenue Bonds, which has been restricted by enabling legislation. The amounts equal the excess of unspent emergency assessments collected to satisfy the debt service requirements for the year.

9. COMPENSATED ABSENCES

Employees earn and accrue vacation and sick leave at various rates, depending on their years of service. The amount of sick leave that may be accrued by each employee at any given time is a maximum of 20 days. The maximum vacation carry over at the end of the year is five days. Upon termination, employees are compensated for any unused vacation leave at the employee's hourly rate of pay at the time of termination.

The liability for unused vacation leave at December 31, 2008, computed in accordance with GASB Codification Section C60, is estimated to be $33,216.

10. RETIREMENT SYSTEM

Defined Benefit Plan

Prior to September 1, 2008, Citizens sponsored a noncontributory defined benefit pension plan covering all employees that were hired on April 1, 2008, from a services agreement with the Property Insurance Association of Louisiana (PIAL) in which retirement expenses were previously reimbursed to PIAL. Retirement expenses reimbursed to PIAL as of March 31 were $61,293. For the period of April 1 to August 31, 2008, Citizens contributed $34,761 to the defined benefit pension plan. In December, Citizens contributed an additional $369,000 to offset market value asset losses in the defined benefit pension plan. As of December 31, 2008, Citizens' defined benefit pension plan was fully funded.

As of September 1, 2008, Citizens froze its defined benefit pension plan and converted to a defined contributed pension plan.

Defined Contribution Plan

Citizens' employees are covered by a qualified defined contribution pension plan sponsored by Citizens. As of September 1, 2008, Citizens froze its defined benefit pension plan and converted to a defined contribution pension plan.

Citizens contributes 11% of each employee's wages to the defined contribution plan. Citizens' contribution for the plan was $249,431 in 2008. Citizens expensed the contributions each month and carries no assets or liabilities for the defined contribution pension plan on its balance sheet.

11. OTHER POSTRETIREMENT BENEFITS

Any Citizens' employee retiring must meet all of the following criteria to receive continuation of health coverage:

- Retire between the ages of 55 to 65
- Have 15 years of service
- Be currently employed with Citizens at the date of retirement
- Retire in good status

If the retiree meets the criteria above, Citizens contributes 75% of the premium. Retirees contribute 25% of the premium. This continuation of health coverage is available until the retiree is eligible for Medicare coverage.

12. SPECIAL ASSESSMENT REVENUE BONDS

On April 11, 2006, Citizens offered for public sale $678,205,000 in Series 2006B and $300,000,000 in Series 2006C Special Assessment Revenue Bonds. The bonds were issued to eliminate the 2005 plan year deficit resulting from hurricanes Katrina and Rita. The bonds and interest will be payable from emergency assessment revenues during 2007 and subsequent years. The Series 2006B bonds bear variable interest rates from 4% - 5.25% per annum and the Series 2006C bonds will bear interest at an Auction Mode Rate resulting from auction procedures. The Series 2006B bonds were sold at a premium of $33,828,701, which is being amortized using the interest rate method and reported as a component of interest expense in the financial statements.

Bond activity for the year ended December 31, 2008, was as follows:

	Balance January 1, 2008	Increases	Decreases	Balance December 31, 2008
Special Assessment Revenue Bonds:				
Series 2006B	$678,205,000			$678,205,000
Series 2006C	300,000,000			300,000,000
Total Outstanding Principal on Bonds	978,205,000	NONE	NONE	978,205,000
Bond Premium on Series 2006B	28,472,012	NONE	($3,110,337)	25,361,675
Total Special Assessment Revenue Bonds	$1,006,677,012	NONE	($3,110,337)	$1,003,566,675

Debt service requirements at December 31, 2008, were as follows:

Year Ending	Series 2006B Revenue Bonds		Series 2006C Revenue Bonds		Total Debt Service	
December 31,	Principal	Interest	Principal	Interest	Principal	Interest
2009	$31,800,000	$33,004,987	$16,350,000	$20,553,512	$48,150,000	$53,558,499
2010	34,360,000	31,363,825	1,670,000	17,226,419	36,030,000	48,590,244
2011	35,080,000	29,677,813	2,745,000	17,160,193	37,825,000	46,838,006
2012	37,735,000	27,927,663	1,800,000	17,090,893	39,535,000	45,018,556
2013	39,600,000	25,986,075	1,860,000	17,030,219	41,460,000	43,016,294
2014 to 2018	227,005,000	97,180,744	13,835,000	83,526,200	240,840,000	180,706,944
2019 to 2023	272,625,000	33,083,113	34,925,000	79,189,956	307,550,000	112,273,069
2024 to 2027			226,815,000	22,565,072	226,815,000	22,565,072
Total	$678,205,000	$278,224,220	$300,000,000	$274,342,464	$978,205,000	$552,566,684

On March 31, 2009, the Series 2006C Variable Auction Rate Bonds were refinanced into fixed rate bonds. Interest rates on the bond periodically adjust over time from 2.75% to 6.75%. The debt service requirements listed above reflect the new fixed rate bonds.

13. RELATED PARTY TRANSACTIONS

Citizens entered into an agreement for services with PIAL effective January 1, 2004, whereby PIAL performs for Citizens on a cost and expense reimbursement basis without profit, commission or fees to PIAL, such services as may be required to operate and administer Citizens' business activities. Until approximately June 2007, Citizens and PIAL were governed by common board members and corporate officers. This agreement was terminated by Citizens' management as of April 1, 2008.

14. COMMITMENTS

Citizens entered into Service Provider Agreements with Bankers Insurance Group, First Premium Insurance Group, Inc., and MacNeill Group, Inc., to provide underwriting, policy issuance and administration and claims processing services beginning October 1, 2005, and ending September 30, 2008. Two service provider contracts have been extended until March 31, 2009. Policy administration services are performed for a fixed fee per application/policy and claims administration services are performed for a percentage of net loss paid, subject to a minimum and maximum dollar fee.

15. SUBSEQUENT EVENTS

To mitigate interest rate exposure resulting from current volatility in the municipal market for auction rate securities, Citizens completed a conversion and remarketing of the Series 2006C ($300,000,000) bonds from the auction mode rate to the long-term interest rate during the second quarter of 2009. By converting to a long-term interest rate, Citizens realized a savings of approximately $18 million in annual interest expense, approximately $244 million in debt service over the life of the bonds, and approximately $118 million in present value savings.

16. GOING CONCERN

Because of the catastrophic effects of hurricanes Katrina and Rita, Citizens maintains a deficit in net assets of $943,927,216 ($96,320,878 for the Coastal Plan and $847,606,338 for the FAIR Plan) at December 31, 2008. R.S. 22:2307(E) states that in the event that a deficit is not remedied by the regular assessment described in note 4, Citizens may declare an emergency assessment. The amount of the emergency assessment in any year must not exceed either 10% of the remaining deficit or 10% of the aggregate statewide direct written premium for subject lines of business. Management began the process to alleviate the deficit by issuing revenue bonds in April 2006, which will be retired using annual emergency assessments that began January 1, 2007. Revenues from the emergency assessments will be recognized as they are levied.

17. CONTINGENCIES

Pending Litigation

Citizens is a defendant in three class action suits resulting from hurricanes Katrina and Rita. In one of the class action suits, *Oubre v. Louisiana Citizens Property Insurance Corporation*, Citizens received an adverse decision which resulted in a $95 million judgment. Citizens is appealing the judgment and in August 2009 paid plaintiffs' attorneys $6 million to avoid filing an appeal bond. Citizens believes that the judgment will be overturned or the case settled for an amount significantly less than $95 million. Citizens has reserves in its Balance Sheet that are deemed by management to be sufficient to cover the expected outcome of the class action suit.

18. RESTATEMENT OF BEGINNING NET ASSETS

The beginning net assets as reflected on Statement B have been restated to reflect the following changes:

Net Assets at December 31, 2007	($973,611,000)
To correct for a reduction in a prior year liability that was not applied when it was paid	10,734,000
To correct for a prior year adjustment to salvage and subrogation	(7,940)
Net Assets at December 31, 2007, as restated	($962,884,940)

The material presented in this section is designed to provide the reader with additional information supporting the financial statements.

Combining Schedule of Net Assets, by Coastal and FAIR Plans

Schedule 1 presents the current and long-term portions of assets and liabilities and net assets for each plan within the Louisiana Citizens Property Insurance Corporation. Included in Schedule 1 are amounts due to and due from other plans. While these due to and due from amounts have been reported at net or eliminated in the consolidated statements, they are shown when presenting individual plan's financial information.

Combining Schedule of Revenues, Expenses, and Changes in Net Assets, by Coastal and FAIR Plans

Schedule 2 presents information showing how the net assets of each plan changed as a result of current year operations.

Combining Schedule of Cash Flows, by Coastal and FAIR Plans

Schedule 3 presents information showing how each plan's cash changed as a result of current year operations.

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Schedule 1

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA

Combining Schedule of Net Assets, December 31, 2008

	COASTAL PLAN	FAIR PLAN	TOTAL
ASSETS			
Current assets:			
Cash and cash equivalents	($173,568)	$16,557,237	$16,383,669
Cash restricted to satisfy restricted liabilities	445,969	6,222,951	6,668,920
Interest and dividends receivable		4,933	4,933
Premium receivables and agent's balances, net	1,993,420	20,406,687	22,400,107
Reinsurance receivables, net	9,388,668	122,213,380	131,602,048
Deferred policy acquisition cost	883,431	10,354,747	11,238,178
Receivable from claim settlement		15,000,000	15,000,000
Emergency assessments receivables, net		20,065,414	20,065,414
Prepaid reinsurance premiums	360,690	9,944,729	10,305,419
Due from other funds		75,038,383	75,038,383
Other current assets	269,985	7,492,425	7,762,410
Total current assets	13,168,595	303,300,886	316,469,481
Noncurrent assets:			
Restricted investments with bond trustee		190,307,224	190,307,224
Bond issuance costs, net		21,294,394	21,294,394
Capital assets, net of accumulated depreciation		5,161,302	5,161,302
Total noncurrent assets	NONE	216,762,920	216,762,920
Total assets	13,168,595	520,063,806	533,232,401
LIABILITIES			
Current liabilities:			
Unpaid losses and loss adjustment expenses	23,323,828	228,567,441	251,891,269
Unearned premiums	8,834,361	103,547,471	112,381,832
Advance premiums	330,877	6,315,614	6,646,491
Unearned tax exempt surcharge	280,677	3,729,301	4,009,978
Commissions payable to agents, net	407,365	3,815,234	4,222,599
Accrued expenses, taxes, licenses, and fees	347,589	3,739,131	4,086,720
Accrued bond interest payable		4,849,043	4,849,043
Take-out program	27,795	2,125,016	2,152,811
Special assessment revenue bonds		48,150,000	48,150,000
Due to other funds	75,038,383		75,038,383
Other current liabilities	452,629	7,861,187	8,313,816
Total current liabilities	109,043,504	412,699,438	521,742,942
Noncurrent liabilities - special assessment revenue bonds	NONE	955,416,675	955,416,675
Total liabilities	109,043,504	1,368,116,113	1,477,159,617
NET ASSETS			
Invested in capital assets, net of related debt		5,161,302	5,161,302
Restricted for debt service (note 8)		74,322,314	74,322,314
Unrestricted	(96,320,878)	(927,089,954)	(1,023,410,832)
Total net assets	($96,320,878)	($847,606,338)	($943,927,216)

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Schedule 2

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA

Combining Schedule of Revenues, Expenses, and Changes in Net Assets
For the Year Ended December 31, 2008

	COASTAL PLAN	FAIR PLAN	TOTAL
OPERATING REVENUES			
Premiums:			
Premiums earned	$19,735,942	$265,225,095	$284,961,037
Premiums ceded	(3,983,869)	(89,150,508)	(93,134,377)
Total net premiums earned	15,752,073	176,074,587	191,826,660
Finance and service charges	218,428	4,093,616	4,312,044
Interest income	35,499	3,540,568	3,576,067
Other	1,162	35,268	36,430
Total operating revenues	16,007,162	183,744,039	199,751,201
OPERATING EXPENSES			
Losses incurred and loss adjustment expenses	35,559,925	160,717,776	196,277,701
Underwriting expenses	2,638,758	39,433,038	42,071,796
Total operating expenses	38,198,683	200,150,814	238,349,497
Operating loss	(22,191,521)	(16,406,775)	(38,598,296)
NONOPERATING REVENUE (Expenses)			
Interest expense		(63,488,508)	(63,488,508)
Net investment income		7,201,233	7,201,233
Emergency assessment income		103,646,244	103,646,244
Market equalization charges	6,429	7,601	14,030
Excess regular assessment recoupments	1,525,134	186,939	1,712,073
Tax exempt surcharge	585,550	7,885,398	8,470,948
Total nonoperating revenues (expenses)	2,117,113	55,438,907	57,556,020
Change in Net Assets	(20,074,408)	39,032,132	18,957,724
Net Assets at Beginning of Year, Restated	(76,246,470)	(886,638,470)	(962,884,940)
Net Assets at End of Year	($96,320,878)	($847,606,338)	($943,927,216)

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Schedule 3

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA

Combining Schedule of Cash Flows
For the Year Ended December 31, 2008

	COASTAL PLAN	FAIR PLAN	TOTAL
CASH FLOWS FROM OPERATING ACTIVITIES			
Premiums collected	$15,389,964	$154,763,196	$170,153,160
Net investment income received	35,499	3,540,568	3,576,067
Finance and service charges	218,428	4,093,616	4,312,044
Other receipts	1,162	35,268	36,430
Losses paid	(51,266,976)	(345,506,399)	(396,773,375)
Loss adjustment expenses paid	(7,198,673)	(59,308,913)	(66,507,586)
Underwriting expenses paid	(3,535,649)	(43,446,004)	(46,981,653)
Net cash used by operating activities	(46,356,245)	(285,828,668)	(332,184,913)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Interfund borrowing	40,126,159	(40,126,159)	
Emergency assessments received	266,159	96,732,961	96,999,120
Regular assessments received	1,525,134	186,939	1,712,073
Market equalization charges received	6,429	7,601	14,030
Tax exempt surcharge received	593,548	7,807,132	8,400,680
Interest paid on debt		(63,730,722)	(63,730,722)
Net cash provided by noncapital financing activities	42,517,429	877,752	43,395,181
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES			
Purchases of capital assets		(37,733)	(37,733)
Net cash used by capital financing activities	NONE	(37,733)	(37,733)
CASH FLOWS FROM INVESTING ACTIVITIES			
Amounts received from restricted investments with bond trustee		142,023,205	142,023,205
Interest and dividends		7,917,268	7,917,268
Net cash provided by investing activities	NONE	149,940,473	149,940,473
Net decrease in cash and cash equivalents	(3,838,816)	(135,048,176)	(138,886,992)
Cash and cash equivalents, beginning of year	4,111,217	157,828,364	161,939,581
CASH AND CASH EQUIVALENTS, END OF YEAR	$272,401	$22,780,188	$23,052,589

(Continued)

Schedule 3

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA
Combining Schedule of Cash Flows
For the Year Ended December 31, 2008

	COASTAL PLAN	FAIR PLAN	TOTAL
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES			
Operating loss	($22,191,521)	($16,406,775)	($38,598,296)
Adjustments to reconcile operating loss to net cash used by operating activities:			
Depreciation expense		2,709,782	2,709,782
Changes in net assets and liabilities:			
Decrease (increase) in:			
Premiums receivable and agents' balances	(282,786)	(1,110,351)	(1,393,137)
Reinsurance receivables	(1,190,268)	(36,749,105)	(37,939,373)
Deferred policy acquisition costs	25,498	2,337,142	2,362,640
Receivable from claims settlement		(15,000,000)	(15,000,000)
Prepaid reinsurance premiums	(360,690)	(9,944,729)	(10,305,419)
Other current assets	(269,985)	(7,491,636)	(7,761,621)
Increase (decrease) in:			
Unpaid losses and loss adjustment expenses	(21,817,448)	(192,343,292)	(214,160,740)
Unearned premiums	(254,931)	(23,371,418)	(23,626,349)
Advance premiums	175,608	3,170,378	3,345,986
Commissions payable to agents	(31,619)	(326,547)	(358,166)
Accrued taxes, licenses, fees, and other expenses	(621,649)	(448,985)	(1,070,634)
Take-out program liabilities	27,795	2,125,016	2,152,811
Other current liabilities	435,751	7,021,852	7,457,603
Net cash used by operating activities	($46,356,245)	($285,828,668)	($332,184,913)

(Concluded)

OTHER REPORT REQUIRED BY

GOVERNMENT AUDITING STANDARDS

The following pages contain a report on internal control over financial reporting, and on compliance with laws and regulations and other matters as required by *Government Auditing Standards*, issued by the Comptroller General of the United States. This report is based on the audits of the financial statements and references, where appropriate, any significant deficiencies and/or material weaknesses in internal control or compliance and other matters that would be material to the presented financial statements.

LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA

December 24, 2009

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Basic Financial Statements

BOARD OF GOVERNORS OF THE
LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA
Metairie, Louisiana

We were authorized to audit the financial statements of the business-type activities of the Louisiana Citizens Property Insurance Corporation (Citizens), a component unit of the State of Louisiana, as of and for the year ended December 31, 2008, which comprise Citizens' basic financial statements and have issued our report thereon dated December 24, 2009. Our audit was to have been conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. However, because of the inadequacies in Citizens' user access controls and other weaknesses in its computer systems, the lack of monitoring of the activities of Citizens and its service providers, the deficiencies in Citizens' processes to develop loss liabilities, receivables, and other financial statement information, and other matters as further discussed in this internal control and compliance report, we were limited in our ability to apply sufficient auditing procedures to enable us to apply the foregoing standards and, therefore, we were not able to express an opinion on the aforementioned financial statements.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered Citizens' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Citizens' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Citizens' internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed in Exhibit B, we identified deficiencies in internal control over financial reporting that we considered to be significant deficiencies.

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A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Citizens' ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Citizens' financial statements that is more than inconsequential will not be prevented or detected by Citizens' internal control. We consider all of the deficiencies described in Exhibit B to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Citizens' internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, because the control deficiencies described in Exhibit B are pervasive and interrelated, they are all considered to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Citizens' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, for the matters described in Exhibit B related to noncompliance with state eligibility requirements, the December 2008 rate-filing did not comply with state law, noncompliance with policy take-out program requirements, and inaccurate calculation of emergency assessments on premium changes.

OTHER REPORTS

On November 5, 2008, a compliance audit report titled *Louisiana Citizens Property Insurance Corporation* was issued by the Louisiana Legislative Auditor. The report presents the results of procedures performed on all of the expenses incurred by Mr. Terry Lisotta, former executive director, from December 2003 through December 2006. The report disclosed findings relating to alleged expenses that were not incurred; personal expenses; expenses with no documented business purposes; duplicated expenses; and fictitious receipts to support expenses that may not have been incurred.

On May 13, 2009, a performance audit report titled *Louisiana Citizens Property Insurance Corporation 2008 Rate-Filing* was issued by the Louisiana Legislative Auditor. The report disclosed that Citizens' December 2008 rate-filing did not comply with all aspects of state law and Citizens cannot ensure that its December 2008 rate-filing was actuarially justified.

On October 7, 2009, a financial audit report was issued on the Department of Insurance for the fiscal year ended June 30, 2008. That report disclosed that the Louisiana Citizens Property Insurance Corporation's 2007 residential rate-filing (excluding wind and hail-only coverage), which was submitted to the Louisiana Insurance Rating Commission in November 2007, was based on improperly adjusted data.

Those reports, including recommendations for improvement and management's responses, can be found at the Louisiana Legislative Auditor's Web site at www.lla.la.gov.

This report is intended solely for the information and use of Citizens' management and Board of Governors and the Louisiana Legislature and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this report is distributed by the Legislative Auditor as a public document.

Respectfully submitted,

Daryl G. Purpera

Daryl G. Purpera, CPA
Temporary Legislative Auditor

DSG:ES:EFS:PEP:dl

LCPIC09

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Schedule of Findings and Recommendations

Lack of Controls Over Administering and Monitoring User Access

Louisiana Citizens Property Insurance Corporation (Citizens) granted employees and non-employees excessive, inappropriate access to the Louisiana Plans Management System (LPMS) and Fiserv, which allowed users the access to make changes to critical data, exposing Citizens to potential error and fraud. LPMS is used for maintaining insurance policies and claims processing. Fiserv is the general ledger system used for disbursements and financial statement preparation. Citizens lacked proper controls over the granting and termination of user IDs in its systems, lacked proper segregation of duties, and did not properly review and monitor accesses granted.

Good internal controls require segregation of duties to reduce the ability of a single individual to compromise a critical process. Also, personnel should perform only authorized duties relevant to their respective jobs and positions, and only appropriately authorized individuals should be granted access to system resources. In addition, when employees are transferred or terminated, their access privileges to system and application resources should be removed immediately.

Although it may be appropriate for a few designated employees to have "change" access to all data in a particular system, this level of access should be granted on a strict business-need-only basis and should be very tightly controlled and monitored. Most of the accesses listed below have been in place since October 2005.

LPMS

As of May 2009, 137 active user IDs were granted "Consultants-SBS" role in the LPMS database, allowing users the ability to make changes to any data in the system, including, but not limited to, policies, agents, claims, claim payments, percentage commissions paid to agents, policyholder addresses, billing history, and premium amounts received or owed.

Of the 137 user IDs with these broad access rights:

- 77 belonged to Citizens' employees;
- 15 could not initially be identified by Citizens; however, after several months Citizens identified seven (two Property Insurance Association of Louisiana (PIAL) employees, two PIAL employees who terminated, two Department of Insurance employees, and an American Insurance Association Board member) and labeled the other eight IDs as former Citizens' temporary employees;
- 22 were generic IDs;

- 14 belonged to the service providers Bankers Insurance Group and First Premium Insurance Group who are contractors assigned policies for underwriting and claims administration;

- 7 belonged to employees of PIAL, three of whom have terminated employment with PIAL; and

- 2 belonged to terminated Citizens' employees. At the test date, one employee had been terminated for nine months and the other for 12 months.

In addition, employees and nonemployees with LPMS user IDs were assigned the "SBS Consultants" job title that enables the user to approve claims over $25,000 using the LPMS claim approval screen. These included four unidentified users; one employee who does not have a valid business need; five generic user IDs; one terminated PIAL employee; and one service provider user.

We could not determine who had access to one generic user ID titled "Mail Clerk Claims" that was inappropriately assigned the "Claims Manager" job title and can approve claim payments totaling $25,000 or less and approve all loss adjustment expenses. This user ID has existed since January 2006.

<u>Fiserv</u>

Within Citizens' accounting section, job functions assigned and accesses granted to employees did not appropriately segregate the functions of authorization, data entry, generation, and review of disbursements. Because of excessive access granted to the Fiserv application, users were allowed access to make unauthorized changes to accounting data that included, but were not limited to, payee names, addresses, disbursement amounts, and journal entries. Of the 18 active user IDs:

- 14 had full administrative access allowing any change in the Fiserv system and 13 of the 14 also had full access to LPMS through the Consultants-SBS role, and

- 4 had profiles with rights to change vendors, claimants, and disbursement data and three of the four also had full access to LPMS through the Consultants-SBS role.

In addition, all 13 employees in the accounting section plus seven additional users had access to a shared directory on the network that gave them the ability to alter bank reconciliations and unencrypted batch files used to post payments and process disbursements.

Citizens' management allowed numerous users to work around LPMS malfunctions in the period surrounding hurricanes Katrina and Rita in 2005 by assigning the Consultants-SBS role, and thereafter continued to grant this access because of a lack of formal procedures and a limited technical knowledge of LPMS. Citizens has not adequately defined its security administrator function and has no formal written security policies and procedures for granting user IDs. In addition, Citizens does not have an adequate definition of authority and responsibility to use as a basis for defining security permissions and roles and for designing forms to be used to approve access rights.

Although Citizens has certain controls to detect unauthorized payments and errors, most of the users with these accesses granted could potentially bypass these controls undetected. Also, because Citizens does not monitor the logs in these systems for unauthorized activity, the risk of error or fraud increases for claim payments, adjustment of premiums, policy issuance, and bank and system reconciliations. Without formal procedures for granting and removing access rights, Citizens may be unable to effectively track, appropriately assign, and remove accesses for employees and nonemployees to prevent future unauthorized access.

Citizens' management should (1) review job descriptions to develop or identify appropriate system access profiles; (2) assign system and network accesses according to job function based on business need and classification of data; (3) create a detailed system access request form for use in granting and revoking access; (4) develop, implement, and follow appropriate access policies and procedures; (5) produce user access reports for supervisors to routinely search for inappropriate access; and (6) consider minimizing or eliminating the use of the Consultants-SBS role. Management concurred in part with the finding. Management concurred that the Consultants-SBS role was too broad and noted that all but three users have been eliminated. In addition, management provided that Fiserv job descriptions and needs have been reviewed and access has been reduced (see Appendix A, page 1).

Additional Comments: Given the broad accesses granted to user IDs and the lack of system monitoring controls, neither Citizens nor the auditors could support management's assertion that it has never had any unauthorized access or changes made to programs or data in its systems.

Lack of Monitoring Over Service Providers

Citizens did not perform adequate monitoring or internal audits on the procedures, controls, and transactions processed at the three service providers that it used to perform insurance policy administration and the related claims services for policyholders. Citizens also did not obtain Type II, Statement on Auditing Standards (SAS) 70 reports on its service providers. Good internal controls require an entity to monitor, review, test, and evaluate the transactions controlled or affected by its service providers to ensure data integrity, completeness, and accuracy. One means of gaining assurance on the controls within a service organization is through Type II, SAS 70 reports.

SAS 70: *Service Organizations* is an auditing statement issued by the American Institute of Certified Public Accountants (AICPA). Service organizations are typically entities that provide outsourcing services that impact the control environment of the company using the service. Citizens had contracts with three service providers in 2008 to provide policy administration and policyholder claims-related services. SAS 70 provides guidance to service auditors when assessing the internal controls of a service organization and issuing a service auditor's report. SAS 70 also provides guidance to auditors of financial statements of an entity that uses one or more service organization. A Type II service auditor's report, as per SAS 70, includes the service auditor's opinion on the fairness of the presentation of the service organization's description of controls that had been placed in operation and the suitability of the design of the controls to achieve the specified control objectives; and whether the specific controls were operating effectively during the period under review. The contracts between Citizens and its service providers do not require that the service providers obtain Type II, SAS 70 reports.

Citizens' employees were not required by internal policy to review transactions in amounts less than the Service Provider Authority Threshold, which include general claims under $25,000 and catastrophic claims up to $75,000. The claims that were less than the service provider's authority threshold comprised 60,547 out of 61,229 claims (99%) in 2008. The lack of review and approval of these transactions by Citizens' employees increases the risk that there may be errors or fraudulent activity related to claims loss payments within the service provider's authority threshold amounts and could result in misstatements to the financial statements. This risk emphasizes the need for monitoring of the service centers.

Although the contracts with the service providers do not require Type II, SAS 70 reports, the contracts do provide that Citizens can perform operational audits at the service centers. Citizens did not conduct operational audits of the service centers in 2008. Although Citizens did contract for some review services in 2009 after the fiscal year under audit, those procedures were not an adequate substitute for obtaining Type II, SAS 70 reports on the service providers.

Citizens placed its faith in the performance of the service providers without externally monitoring that performance. Failure to perform sufficient operational audits or to obtain SAS 70, Type II reports on each of its service providers results in the inability to ensure that procedures and controls are being applied in accordance with Citizens' intentions and regulations and increases the risk that contract terms are not being followed, which could result in errors, overpayments, financial misstatements, or fraud.

Management should institute controls to monitor, review, internally audit, and evaluate the performance of its service providers. Citizens should prepare, sign, and enforce contracts with all service providers that clearly define Citizens expectations from its service providers and require Type II, SAS 70 audits from those service providers. Management concurred in part with the finding. Management concurred that Type II, SAS 70 reports were not obtained on the service providers, but noted that Type I, SAS 70 reports were available for two service providers and operational reviews were conducted in 2007, 2008, and 2009 (see Appendix A, page 2).

Additional Comments: Type II, SAS 70 reports were not obtained and operational reviews were not performed in the year under audit, 2008.

In response to our requests for copies of all SAS 70 audits, Citizens' management provided one Type I, SAS 70 report on BinTech Partners, Inc., which according to Citizens' management is wholly owned and one of the new companies under Bankers Insurance Group (a Citizens' service provider). We were not informed of or provided a second Type I, SAS 70 report.

In the Type I report we were given, the service auditor noted that he did not perform procedures to determine the operating effectiveness of controls for any period and expresses no opinion on the operating effectiveness of any aspects of BinTech's controls. His opinion addressed the "description of controls." A Type I, SAS 70 report does not provide Citizens' management with assurance that service providers' controls are operating effectively. Considering the extent of the transactions processed by service providers that are also not reviewed or approved by Citizens' employees, this lack of assurance is critical.

Our review and testing of Citizens' procedures provided no evidence to support management's assertion that monitoring procedures at the service centers were in place for 2008. The examples of operational reviews provided by management included a follow-up by the service provider itself for concerns Citizens determined in 2007, and two chartered property casualty underwriter's reports on limited procedures performed on the three service providers.

One chartered property casualty underwriter's report was related to two service providers and described limited procedures that included samples of 16 Hurricane Gustav claims for one provider and 29 claims from the other provider to review "claim performance." The report described claims handling capabilities and performance but provided no assurances to Citizens' management regarding the operating effectiveness of service providers' controls.

The other report related to the third service provider and described limited procedures that included a sample of 45 claims to review performance and to identify and assess any unresolved claim exposure. While this report related to performance measurement against best claims practices, the purpose of the report was not to provide assurances relating to the operating effectiveness of service provider's controls, as would be the case in a Type II, SAS 70 audit.

Inadequate Loss Reserve Development Process

Citizens does not have an adequate process to develop loss and loss adjustment expense (LAE) reserve liabilities. Citizens is required to estimate the ultimate cost of settling insurance claims, including costs related to claims that were incurred but not reported, using past experience adjusted for current trends. Management is responsible for its estimates and the implementation of controls to ensure that the data used in deriving these estimates are complete and accurate. Citizens engages an outside actuary to assist in the estimation of the loss and LAE reserve liabilities based on data provided by Citizens.

Although an unfavorable judgment of $95 million was issued to Citizens on March 20, 2009, on a class action suit related to prior years' hurricane claims, there was no evidence that Citizens made any provision in the reserve amount for this case or other pending class action suits and mass joinders. The appointed actuary's Statement of Actuarial Opinion as of December 31, 2008, noted that the loss reserves carried by Citizens do not include provision for possible unfavorable outcomes concerning four pending class action suits and 16 mass joinders against Citizens. The actuary's opinion states, in part, "The scope of my opinion does not include any provisions for these (or possible future) class action suits and mass joinders. Therefore, my opinion is qualified in this regard." In addition, during tests of loss claims and loss reserves, auditors did not find any items within the recorded reserves tested that made provision for amounts related to these class action suits and mass joinders.

Audit procedures identified various errors and deficiencies in the data that was relied on by the appointed actuary to develop the estimate of reserves at December 31, 2008, as follows:

1. Case basis loss reserves related to system claims do not appear to include all appropriate amounts at year-end. Auditors ran a query on loss payments issued in the first three months of 2009 related to claims with (1) a loss occurrence date prior to the end of 2008; (2) a loss report date prior to the end of 2008; and (3) no reserve amount in the outstanding claim register. This procedure identified 4,257 payments totaling approximately $23 million. A review of the transactions identified errors indicating that case basis loss reserves did not include all appropriate claims at December 31, 2008. Specific errors included:

    - Reserves associated with several claims appear to have been closed out as a result of advance (partial) payments coded as "final" payments in the claims system.

    - Reserves were not reestablished for claims with payments that were issued and voided prior to year-end and were reissued subsequent to year-end.

    - Reserve balances were not established for certain claims although documentation in the claim file at December 31, 2008, indicated that the amount of the loss was known.

    - Amounts related to off-system, manually processed claims were excluded from direct case basis loss reserves for all accident years. At December 31, 2008, these amounts were approximately $2.8 million for case basis loss reserves and approximately $60,000 for LAE reserves.

2. Case basis loss reserve balances included approximately $1.4 million on claims that were closed and had no loss reserves as of December 31, 2008.

3. Citizens did not appropriately classify paid LAE and LAE case reserves as defense and cost containment (DCC) expenses or adjusting and other (A&O) in accordance with Statement of Statutory Accounting Principle (SSAP) No. 55. As a result, DCC paid and case basis reserve data relied on by the appointed actuary is inaccurate.

4. During a review of case reserves related to litigated claims, the following discrepancies between reserves recorded by Citizens and the value of the loss represented to the auditors by Citizens' outside legal counsel were identified:

   - One claim with a recorded reserve at December 31, 2008, of $220,000 was settled in 2007 and therefore should not have had a reserve balance at December 31, 2008.

   - Two claims with recorded reserves of $16,000 had probable outcomes estimated in the range of $700,000 and $1.3 million based on information from legal counsel.

   - Seven claims with total recorded reserves at December 31, 2008, of approximately $2 million were settled or tentatively settled in 2009 for approximately $334,000. Citizens' recorded reserves for these seven cases ranged from $206,000 to $450,000 per claim, and the settlement (or tentative settlement) amounts ranged from $5,000 to $130,000 per claim.

   - Four claims with total recorded reserves of $1.2 million had probable outcomes estimated in the range of $290,000 to $400,000 based on information from legal counsel.

These conditions are the result of inadequacies in Citizens' information systems and inadequate procedures to ensure that loss information is complete and accurate. Furthermore, Citizens is not timely updating case reserves to reflect the best available information. Failure to maintain accurate and complete information related to losses and loss adjustment expenses hampers the estimation process and increases the risk of material misstatement of liabilities and expenses reported in the financial statements.

Management should establish an adequate process to develop and report estimated liabilities for losses and loss adjustment expenses. This process should include formal procedures to identify and fully compensate for inadequacies in Citizens' information system that affect the data used to develop the estimate of loss and LAE reserves. In addition, Citizens should provide for the timely update of reserves to reflect the most complete and accurate available information. Management did not concur with the finding and noted that the Loss and LAE reserves of $170 million were in the range of a detailed analysis conducted by the contracted actuarial firm. Management stated, in part, that (1) the payments were made after the reserves were established and the reserve is always different than the payment; (2) there have always been manual commercial claims without case reserves included in the overall reserve process; (3) the DCC and A&O classifications relate to timing; (4) the items mentioned in 4. in the finding are very small misclassifications; and (5) lawyers do not set reserves for insurance companies (see Appendix A, pages 3-4).

Additional Comments: Auditing standards require auditors to obtain and evaluate sufficient appropriate audit evidence to support significant accounting estimates. Reviewing transactions and events subsequent to the financial statement date are included among the procedures prescribed by the auditing standards for auditors to use in evaluating management's estimates.

The loss and LAE reserves reported in the financial statements are an estimate of the future payments for claims related to insurable events that have occurred as of the balance sheet date. These liabilities include provisions for claims that have been reported as of the balance sheet date (case basis reserves) and provisions for claims that have not yet been reported as of the balance sheet date (incurred but not reported reserves). The ultimate reserve liabilities reported in the financial statements are actuarial estimates based on historical loss and loss adjustment expense development adjusted for current trends. In 2008, an independent actuary was engaged to assist in the estimation of the reserve liabilities.

In the Actuarial Report on *Unpaid Claim and Claim Expense Estimates* as of December 31, 2008, the independent actuary stated, in part, that the actuarial firm relied upon the accuracy of the Citizens' data provided for their analysis and if the data is inaccurate or incomplete, their estimates may need to be revised.

The independent actuary represented that he relied on Citizens' case basis loss reserve and paid loss data to determine loss development factors and that he applied these development factors to Citizens' case basis loss reserves and paid loss data to derive the estimate of loss reserves reported in the financial statements. Because case basis loss reserves and paid loss data are significant to the estimate of loss reserves, we performed procedures to determine whether case basis loss reserves and paid loss data were reasonably complete and accurate. The conditions identified in our finding demonstrate deficiencies and inaccuracies in the data relied upon by the actuary.

Regarding class action lawsuits, management asserts that the "settlement of the *Orrill* class, by law, eliminates the other classes" and therefore the settlement and IBNR reserves are adequate for the outcomes related to class action suits. Based on our review of the existing information on the cases, management's assertion is incorrect. There are different plaintiffs in the cases in different parishes and different outcomes may occur. In March 2009, a trial court granted the plaintiff's motions for summary judgment filed in December 2008 stipulating monetary damages in excess of $92.8 million in the *Oubre* case.

Regarding numbered items in management's response:

1. It is a common and prudent practice for auditors to determine the reasonableness of accounting estimates and estimation methods by comparing the estimate to actual results. Although we do not consider the $23 million at-risk population identified in our test work to be a known error, we do consider such a large population to indicate that case loss reserves are most likely incomplete. Moreover, management states that ". . . many insurers do not develop case reserves; instead, they use bulk or factor reserves." We acknowledge that it is an acceptable practice in the industry to use other methods when statistical analysis indicates that the ultimate development of the original reserves will be lacking. However, management does not use this methodology.

2. Regarding the exclusion of off-system, manually processed commercial claims, management asserts that these amounts are included in the IBNR portion of loss reserves. While payments related to manually processed commercial claims are included in paid loss development data submitted to the actuary, unpaid amounts related to manually processed claims are excluded from case basis loss reserves that are submitted to the actuary. Since the actuary considered case basis loss reserves to be significant to his estimate of the ultimate loss liability, we consider this condition to be an example of an inadequate process to prepare and submit critical data to the actuary.

3. Management asserts that the inclusion of reserve amounts related to claims that were closed as of December 31, 2008 ". . . is a typical situation that relates to timing . . ." However, this statement directly conflicts with actions taken by management to correct this condition. In February and March of 2009, Citizens investigated each of these claims to determine whether the claims were actually closed at December 31, 2008. According to management, the results of this undertaking indicated that substantially all of these claims should not have had a reserve balance as of December 31, 2008, and the reserves on these claims were subsequently closed in March 2009. While management contends that this condition is "typical," it seems unlikely that such corrective actions would have been taken if this were the case. Because this condition represents an inaccuracy in data that was significant to the actuary's reserve estimate, we consider this evidence that management's process needs revision.

4. Regarding the misclassification of loss adjustment expenses, we believe that this error provides further evidence to indicate that management's process is inadequate. SSAP No. 55, *Unpaid Claims, Losses and Loss Adjustment Expense*, requires insurers to classify loss adjustment expenses as either defense and cost containment (DCC) expenses or adjusting and other (A&O) expenses. The actuary relies on both paid and case reserve DCC to derive his estimate of loss adjustment expense reserves. Citizens' information system does not have the capability to provide for these classifications in accordance with SSAP No. 55. Given this system limitation and the absence of other compensating controls, we believe this to be a deficiency in management's process to submit complete and accurate data to the actuary.

5. Management states that outside legal counsel is not responsible for Citizens' reserve-setting process. This process is management's responsibility. However, for accurate results communication should routinely occur among service providers, Citizens' staff, outside counsel, and actuarial consultants when reserves are established and adjusted. Based on our audit procedures, we believe management's current process is insufficient. At any time, case basis reserves should reflect the best information available, including information from outside legal counsel.

In a 2007 Louisiana Legislative Auditor Performance Audit Division report, it was noted that reserves were not adjusted in a regular and consistent manner. In many cases, the reserves were increased immediately before payment and decreased immediately after payment. Reserves should reflect the most timely and relevant information to date.

Noncompliance With State Eligibility Requirements

Citizens did not follow state law to ensure that all applicants were eligible to be insured by Citizens. Louisiana Revised Statute (R.S.) 22:2302(A) provides that any person having an insurable interest in insurable property and who has been denied coverage by one or more insurers authorized to write property insurance in this state is eligible to apply for insurance through Citizens directly or through a representative. R.S. 22:2302(A) further provides that every application form shall require that the applicant disclose each insurance carrier who denied property insurance coverage to the applicant.

During our test of direct written premiums, 35 applications for policies written in 2008 were reviewed. Of these 35 applications, 34 (97%) did not disclose on the application that the applicant was denied coverage or list each insurance carrier who denied property insurance coverage to the applicant. "No" was checked on the applications for the question "Has insurance been cancelled, declined, or non-renewed in the voluntary market?"

Management expressed that it did not have the means to implement a control to ensure compliance with this provision. Failure to ensure that all policyholders are eligible to be insured by Citizens causes Citizens to be in noncompliance with state law and could result in policies being issued to ineligible applicants, which could lead to payment of losses to an ineligible insured. This also increases the risk of misstatement of premiums earned and claim losses on the financial statements. In addition, the legislation creating Citizens explicitly states that the legislature intends for Citizens to work to reduce the number of policy holders until Citizens is no longer needed. If Citizens issues coverage to those who could get coverage elsewhere, then legislative intent for Citizens to be the insurer of last resort would not be met.

Management should ensure that policies are issued only to those applicants whose application information demonstrates eligibility for coverage as prescribed by state law. Management concurred with the finding and provided that the new policy management system that will be installed in the spring of 2010 will prohibit the issuance of new policies to property owners who have not been denied coverage by another company (see Appendix A, page 5).

Uncertainty in Premiums Receivable

Citizens did not adequately support premiums receivable. Citizens could not provide an accurate and complete aging of premiums receivable, and the results of our tests indicate an uncertainty of the premiums receivable (uncollected premiums) balance at December 31, 2008. Good business practices require that accurate and complete financial records be maintained to ensure that the amounts recorded in the financial statements are materially correct.

Citizens uses its LPMS to process and record premium transactions. However, because of the limitations and unreliability of LPMS, Citizens contracted with a computer consultant to design the Louisiana Citizens Data Mart (Datamart) as a method of obtaining data from LPMS. Datamart reports are used to create the manual general ledger entries to generate financial reports. The aging of uncollected premiums was also determined using the Datamart. Management reported admitted premiums receivable of approximately $23.4 million.

During our testing of admitted uncollected premiums at December 31, 2008, 24 transactions totaling $413,313 were examined. For seven of 24 (29%) transactions tested, the premium balance outstanding at December 31, 2008, was overstated in total by $309,508. Upon further evaluation of the exceptions, the following deficiencies were noted:

- In five exceptions noted above, all or part of the premium payments totaling $225,636 were removed (suppressed) from the receivables balance. While generating the aging of premiums receivable, the computer consultant erroneously removed premium payments thought to be duplicate payments. A total of $960,345 in premiums payments were removed from the premiums receivable balance, which resulted in an overstatement to premiums receivable of $960,345. The monies were appropriately deposited into Citizens' accounts.

- In two exceptions, the premium balance in the aging report was incorrect and there should have been no balance (zero) at December 31, 2008. The computer consultant generates the aging report by pulling the balance from the LPMS policy balance table. When a change is made to the premium amount via an endorsement, LPMS does not process the amounts correctly in the policy balance table, which Datamart uses to create the aging report. Auditors could not determine why LPMS is calculating the amounts incorrectly in the table and therefore cannot determine the extent of the misstatement.

- For one exception, the balance in the aging report was incorrect; the balance should have been zero at December 31, 2008. When a renewal policy cancels before the effective date of the policy, Citizens refunds the entire premium and fees paid by the applicant. However, for such an event, the emergency assessment fee does not zero out in the LPMS policy balance table, which results in a false receivable in the amount of the emergency assessment fee. In each case, the receivable amount should be zero. Based upon the available information, auditors could not determine the extent of the misstatement.

Failure to maintain an accurate and complete aging of premiums receivable has resulted in an uncertainty of the premiums receivable balance reported on the financial statements at December 31, 2008. This increases the risk of material misstatement of premiums receivable on the financial statements.

Management should resolve system errors and/or establish control procedures to provide an accurate and complete aging of premiums receivable and eliminate the uncertainty of the premiums receivable (uncollected premiums) balance at year-end caused by system problems. Management did not concur with the finding, but acknowledged that there are some issues in the LPMS that impact premiums receivable balances. Management expressed that the $960,345 was corrected; the incorrect balances in the aging report had minimal impact; and the emergency assessment differences were only $220,000 (see Appendix A, page 6).

Additional Comments: Management reported admitted premiums receivable of approximately $23.4 million. Our sample identified a 29% error rate. Further evaluation of the exceptions identified inaccuracies in how the receivable balance was determined. With a high sample error rate and the nature of the problems we found, it is likely that additional errors exist and would have significantly higher dollar impact for the whole population.

In regard to the error resulting in false receivables, Citizens' management noted that the differences have been quantified to be approximately $220,000. However, supporting documentation for this amount shows that the amount is netted between negative and positive receivables and includes additional errors not quantified in our finding.

Inaccurate and Incomplete Annual Fiscal Report

Citizens did not submit an accurate and complete Annual Fiscal Report (AFR) to the Division of Administration for the fiscal year ended December 31, 2008. As authorized by R.S. 39:79, the commissioner of administration through the Division of Administration's Office of Statewide Reporting and Accounting Policy (OSRAP) prescribes the content and format for the preparation of each entity AFR, which is then used in the compilation of the state's Comprehensive Annual Financial Report (CAFR) in accordance with accounting principles generally accepted in the United States of America. Good internal control includes establishing a process to ensure that these financial statements are accurately prepared and reviewed.

Citizens' AFR submitted to OSRAP in September 2009 included the following errors and omissions:

- Assets and liabilities were understated by $76,227,692 and had to be increased to report reinsurance receivable as an asset as required by generally accepted accounting principles, instead of netting it against liabilities.

- Assets and liabilities were overstated by $47,234,072 as Citizens incorrectly included inter-fund balances due to and from other funds. These inter-company accounts should have been eliminated from the combined financial statements.

- Assets and liabilities were overstated by $7,847,305 because of an erroneous adjustment made by Citizens as part of a prior period adjustment.

- Current liabilities were overstated by $6,668,920 as Citizens recorded current liabilities for collections of emergency assessments on its own policies. In addition, current assets were overstated by $2,774,363 and revenue was understated by $3,894,557 as Citizens failed to reduce receivables and increase revenues for the emergency assessment collections.

- Assets and revenues were overstated by $960,344 as a Citizens' computer consultant erroneously removed premium payments thought to be duplicate payments causing the payments not to be reflected in the financial statements.

- Citizens did not report $48,150,000 for the current portion of the bonded debt as a current payable. The entire amount of bonded debt was reported as a long-term liability.

- Citizens failed to report net assets as restricted for debt service of $74,322,314 and invested in capital assets net of related debt of $5,161,302. These amounts were incorrectly included in the unrestricted net asset amount.

- Revenues were overstated by $7,847,305 as Citizens included a transaction in prior period adjustments that should have netted to zero, but instead created $7,847,305 current year revenue. In addition, Citizens included an additional $4,161,064 prior period adjustment that was in error. Citizens incorrectly included a line item on its operating statement for prior period surplus adjustments, which should have restated the beginning net assets account balance.

- The account "Net assets at beginning of the year, restated" was understated by $14,887,127 as Citizens recorded transactions that affected beginning net assets as change in allowance for doubtful accounts and prior period surplus adjustments.

- Citizens recorded $6,677,528 separately, as change in allowance for doubtful accounts, instead of netting it against premiums earned.

- Prior period adjustments were not disclosed in the prior period adjustments note of the AFR (note AA) but were instead described in the accounting changes note of the AFR (note N).

- Operating revenues of $7,924,541 were reported as nonoperating revenues.

- Operating revenues should have reported premiums earned of $282,311,752, less premiums ceded of $96,549,785. Instead Citizens reported net premiums written (direct less ceded) of $162,135,619 and changes in unearned premiums (direct less ceded) of $23,626,348.

- Citizens recorded a Service Provider Fee payable of $6,548,606 separately, instead of allocating the portion related to unpaid loss adjustment expenses to the loss and loss adjustment expense liability and the portion related to unpaid underwriting expenses to the accrued expenses, taxes, licenses, and fees liability.

- Citizens' Statement of Cash Flows included numerous adjustments; did not use the correct amount of operating loss, which should have agreed to the amount reported on the Statement of Revenues, Expenses, and Changes in Net Assets, in the reconciliation of operating loss to net cash used by operating activities; and reported five amounts totaling $2,667,349 as noncash activities for items that were cash transactions.

In addition, to these errors noted, two other areas of concern were identified and are described as follows:

- Citizens did not verify the completeness and accuracy of premium and policy data during 2008. As noted in the prior auditor's fiscal year 2007 audit finding titled "Premiums & Claims," Citizens did not have a testing, balancing, and reconciliation function in place for the premium and claims cycles. Citizens did not use the Operational Reporting and Balancing System (ORBS) to independently balance and reconcile data until June 2009, after Citizens' statutory financial statements had been prepared, and approximately six months after the end of the year.

- Citizens did not correctly account for the financing arrangements on the settlement of a legal claim during 2008. The December 31, 2008, financial statements include a current (short-term) receivable for $15,000,000, which is not correctly classified and reported. The recorded receivable has not been received as of December 11, 2009. Citizens did not report the settlement funds as amounts held in trust in the custody of the court. The settlement funds (which include the $15 million recorded as a receivable) should have been reported as restricted assets held in trust, with off-setting liabilities for the amount of the settlement losses to be paid. Citizens did not recognize the activity of the court during the year, if any, which affected the balance of the settlement funds at December 31, 2008. If funds, such as the $15 million Citizens recognized as a receivable, would have appropriately reduced the unfavorable outcome to Citizens, such transaction should have been recorded as a reduction in the payable of the funds in trust, not as a current receivable.

Citizens' personnel made miscalculations, misclassified transactions, excluded transactions, incorrectly adjusted prior year amounts, and used inaccurate data in their preparation of the financial statements and the notes to the financial statements. In addition, the supervisory review process was not effective in identifying the errors and/or omissions in the current and long-term claims liabilities and related notes to the financial statements. Failure to submit an accurate AFR can delay the compilation, issuance, and accuracy of the state's CAFR. Furthermore, misstatements from errors or omissions may occur and remain undetected.

Citizens' management should ensure that its AFR is properly prepared and should review the financial information and note disclosures in its AFR to identify and correct errors before submitting it to OSRAP and the legislative auditor. Management concurred in part with the finding (see Appendix A, pages 7-8).

December 2008 Rate-Filing Did Not Comply With State Law

Citizens' December 2008 rate-filing did not comply with all requirements in state law. R.S. 22:2303 prescribes the requirements for the board's role in rate setting; the commissioner of insurance's role in rate-setting; the frequency of rate changes; the noncompetitive nature of the rates; and the actuarial requirements of the rates. Citizens' rates are not intended to compete with private insurance company rates and must be at least 10% higher than those of the largest insurers with certain exemptions.

As described in the Performance Audit Division's report *Louisiana Citizens Property Insurance Corporation 2008 Rate-Filing* issued May 13, 2009, several aspects of law were not complied with in the December 2008 rate-filing. In October 2008, Citizens submitted a rate-filing to the commissioner requesting an overall average rate increase of 13.7%.

Citizens paid approximately $104,000 for an actuarial consultant to assist in its rate determination and used that information in its initial rate-filing. The commissioner notified Citizens' management that he would not approve the actuarially indicated rates because of pervasive data integrity issues and other deficiencies in the actuarial analysis. Then, without board approval, Citizens' staff submitted a revised rate-filing with a lower average rate increase of 7%, which was then approved by the commissioner and subsequently approved by the board. Since the board did not pre-approve the formulas used by Citizens' staff in setting the revised rates, the board did not fulfill its statutory duty of adopting rate-setting formulas before determining rates.

Citizens used the market survey conducted by the Department of Insurance in setting its rates without evaluating the responses from the surveyed companies. Consequently, Citizens could not have determined if the information was reliable. Because the actuarial information was not used and the survey responses were not evaluated, this process may have inappropriately resulted in noncompetitive rates in noncompliance with state law.

As recommended in the Performance Audit, the Citizens board should vote to adopt rate-setting formulas before determining rates. Citizens' management should perform its own market survey for future rate-filings or obtain and evaluate survey responses from the Department of Insurance if the department does the survey. Citizens should ensure that its rate-filings are actuarially justified as required by law to further ensure they remain noncompetitive. Management concurred in part with our finding noting that it agreed the Citizens board needed to review and approve rates and rating formulas before their effective date. Citizens' management disagreed that the commissioner disapproved the actuarial data because of "pervasive data integrity issues," and provided that instead, the commissioner's disapproval was that the data was unaudited at that time (see Appendix A, page 9).

Additional Comments: In a letter dated December 4, 2008, to Mr. John Wortman, CEO, regarding Citizens' FAIR and Coastal Plans residential rate revision, the commissioner of insurance included, in part, the following statements:

> With regard to the actuarial concerns, there are two categories that have been identified by my actuarial staff. The first actuarial category of concern identifies pervasive data integrity issues underlying the filing's entire actuarial analysis. The second actuarial category of concern deals with specific actuarial methods and assumptions.
>
> The pervasive data integrity issues are significant and overriding to the entire actuarial analysis presented in this filing.
>
> The second category of actuarial concerns, though not as pervasive as the data integrity issue, is significant to the actuarial analysis that determines the rates by parish for each program.
>
> However, without reliable historical data and supporting actuarial analysis, my staff and I are unable to validate or agree with LCPIC's actuarial calculations and assumptions set forth in this rate filing.

The overall statewide rate change for residential programs was approved based on the market survey data.

Noncompliance With Policy Take-Out Program Requirements

Citizens did not comply with the requirements of R.S. 22:2314 regarding the required depopulation of Citizens' policies referred to as the Policy Take-Out Program. R.S. 22:2314 provides that the legislature created Citizens to operate insurance plans as a residual market for residential and commercial property and intends that Citizens work toward the ultimate depopulation of these residual market plans. The Policy Take-Out Program was developed to encourage the depopulation. The statute requires that at least once per calendar year, Citizens shall offer policies for removal to the voluntary market in bundles of at least 500 policies, which include both Coastal and FAIR Plan policies. Citizens shall include policies in the bundle with geographic and risk characteristics that serve to reduce the exposure of the corporation. Each insurer in Louisiana admitted to write residential or commercial policies who desires to participate must submit a take-out plan to Citizens. An insurer shall not be qualified to submit a take-out plan unless that insurer is admitted to write homeowners or commercial insurance in the state of Louisiana. Citizens must submit the plans to the Louisiana Department of Insurance (DOI) for review and approval. If the plan is approved by DOI, Citizens shall submit the plan to its board. The Citizens board shall develop guidelines for the program and file these with the Senate and House committees on Insurance and the commissioner of insurance for approval.

Citizens conducted two rounds of depopulation in 2008, resulting in seven Take-Out companies assuming 39,936 of approximately 170,000 policies (23%). Those policies represented approximately $68 million out of approximately $260 million in premiums (26%), which followed the policies, also reducing Citizens' exposure by an estimated $9 billion.

In testing compliance with R.S. 22:2314, we identified the following noncompliance and weaknesses:

- Citizens offered the total population of in-force policies for take-out but did not bundle them in any way. Instead, the Take-Out companies were given a database of the policies and allowed to selectively determine the policies each company wanted to assume. Citizens then contacted the insurance agents, or producers, to obtain approval to assume those policies. Consequently, Citizens failed to comply with specific bundle criteria outlined in the revised statute that included offering policies in bundles that represented the geographical and risk characteristics of its overall population of policies.

- Although 75,683 (45%) of Citizens' in-force policies had been selected by Take-Out companies, only 39,936 (53%) of those policies were actually depopulated. Citizens interpreted R.S. 22:23 (Exclusive use of expirations) to mean that a policy could not be depopulated unless authorized by the insurance agent. This interpretation may have caused a lesser number of policies to be depopulated since R.S. 22:2314 has no language requiring an insurance agent's authorization.

- Citizens did not collect and submit to DOI any formal Take-Out plans from interested insurance companies as required by R.S. 22:2314. Compliance with this requirement would have ensured that all seven companies that participated in the two rounds of depopulation would have met the eligibility criteria described in the statute. As a result, one company that was not admitted to write policies in Louisiana and another company that did not have a financial rating were allowed to participate and assume 12,382 (31%) of the 39,936 policies.

- The Citizens board did not prepare and submit guidelines for the Take-Out Program to the Senate and House committees on insurance and the commissioner of insurance for approval.

Citizens' management believes that there is a statutory conflict between R.S. 22:23 and R.S. 22.2314 and performed the depopulation process by complying with the latter criteria that could be reasonably met while complying with the constraints required by R.S. 22:23. In addition, management noted that compliance with the bundling requirement could have resulted in none of the bundles being selected since each bundle would likely include "unwanted" policies. However, since R.S. 22:2314 is specific legislation related to Citizens-only, there is no statutory language in R.S. 22:2314 cross referencing R.S. 22:23, and R.S. 22:2314 is a more recent expression of the legislative will, the latest statute would prevail.

The fiscal impact of Citizens' noncompliance with statutory requirements and the resulting effect on premium revenues, claim expenses, and exposure cannot be determined because the number of policies that would have been depopulated if Citizens complied with R.S. 22:2314 is unknown. In addition, failure to have Take-Out plans approved by DOI increases the risk that ineligible companies may be allowed to participate and that these companies could potentially find themselves unable to meet their obligations to the insurance agent or to the policyholder.

Also, failure to submit required Take-Out Program guidelines to the commissioner of insurance and the legislature means that there is no written documentation of approval for the procedures followed by Citizens.

Management should review its implementation of the Policy Take-Out Program and develop formal practices that would ensure compliance with all the requirements specified in R.S. 22:2314 to meet the latest expression of legislative intent. Management concurred in part with the finding. Management acknowledged that two ineligible companies were allowed to participate in the Policy Take-Out Program in 2008. However, management believes that R.S. 22:23 does apply and there is a statutory conflict between R.S. 22:23 and R.S. 22:2314 (see Appendix A, pages 10-11).

Additional Comments: Citizens did not follow R.S. 22:2314, which represents specific legislation related to Citizens and is the latest expression of the legislature's will. As a result, Citizens is in noncompliance with state law.

Inaccurate Calculation of Emergency Assessments on Premium Changes

Citizens did not adjust the emergency assessment surcharge on its policies accurately and in compliance with R.S. 22:2301(E). This statute requires that upon changes to a policy of insurance during the term of the policy that results in an increase or decrease in premium, the emergency assessment is to be adjusted and the amount the insurer shall owe or be owed is to be computed on a pro rata basis for the term of the policy. Citizens is required to levy an emergency assessment surcharge on policies written. The amount collected is a uniform, statewide percentage that is determined annually and approved by DOI. For 2008, this was 5% of the total written premiums.

Citizens did not update its LPMS until February 2009 to properly reflect the changes in statute that were effective January 1, 2008. Citizens' noncompliance with R.S. 22:2301(E) has resulted in policyholders not being charged or refunded emergency assessment amounts on policy premium changes. Because of LPMS limitations, auditors could not determine the amount of the financial misstatement caused by the noncompliance.

Management noted that it became aware mid-2008 that the system was not making the proper emergency assessment adjustments. However, because of the complicated nature of the calculations, the volume of transactions, and the LPMS limitations, management was not able to make any overall retrospective changes to correct the problem. Because Citizens did not update its system in 2008, Citizens placed the burden on the policyholders to discover and seek correction of the emergency assessment amount for their policies.

Management should ensure the calculation and monitoring procedures over emergency assessments result in emergency assessment surcharges that are accurate and in compliance with state law. Management concurred in part to the finding. Management acknowledged that system issues regarding emergency assessments remained in LPMS until corrected in early 2009, but believes the impact of the error is approximately $220,000 (see Appendix A, page 12).

Additional Comments: Citizens' estimate of the approximate error amount of $220,000 does not relate to the problems identified in the finding. The $220,000 is a net amount that was derived from renewal policies that were cancelled before the effective date of the policy. This finding relates to policies with changes to premiums during the term of the policy. We could not determine the extent of the error.

Lack of an Internal Audit Function

Citizens did not have an effective internal audit function in place to examine, evaluate, and report on its internal controls, including information systems, and to evaluate compliance with the policies and procedures that comprise internal controls. An effective internal audit function is an independent appraisal activity within an entity for the review of accounting, financial, and other operations. The overall objective is to carry out a program of tests of the financial and operational activities and transactions to provide management with information about the effectiveness (and efficiency) of established accounting and operational policies, procedures and controls, and the extent to which they are being followed. Another objective is the prevention and detection of fraud through the performance of internal audit tests and procedures.

Management did not establish the internal audit function as a priority in 2008. An effective internal audit function could assist Citizens in the following areas: (1) developing and testing information technology controls; (2) establishing and testing financial reporting controls; (3) testing compliance with applicable laws and regulations; (4) monitoring service providers; and (5) identifying significant risk areas. Failure to establish an internal audit function increases the risk that Citizens' assets are not safeguarded and its policies and procedures are not uniformly applied.

Management should establish an effective internal audit function to ensure that assets are safeguarded and that management's policies, procedures, and controls are applied consistently in accordance with management's intentions. Management concurred in part with the finding. Management noted that Citizens has made progress in developing formal written policies and procedures and internal controls and will continue to examine the benefits of a formal internal audit function (see Appendix A, page 13).

Inadequate Program/System Change Controls

Citizens lacks adequate control over changes to its information technology (IT) programs and systems. Good internal controls would require that management monitor change requests to IT system applications and ensure that program changes are properly evaluated, prioritized, authorized, documented, monitored, and tested prior to implementation. In addition, the roles, tasks, and responsibilities of service providers and customers should be defined; logs of all program/system changes should be maintained; and program changes should be moved into production only when approved by management and persons independent of the programmer.

Audit procedures identified the following:

- Citizens has not properly segregated duties over changes to programs and systems and has not provided proper oversight and review of these changes. The two vendors who maintain the LPMS, Operational Reporting and Balancing System (ORBS), and Datamart have the ability to make changes to source code and data and can have those changes moved into production without Citizens' knowledge.

- Citizens does not have formal, documented procedures in place to ensure that all changes to its systems and data are authorized, prioritized, planned, tested, reviewed, and approved prior to moving into the production environment.

- Citizens and its vendors do not adequately document reported problems and related system changes and do not close all problems or change orders with documented evidence of resolution.

Citizens has not placed sufficient emphasis on the creation, documentation, and enforcement of formal change control procedures. The lack of program/system change controls increases the risk that vendors may make unauthorized, erroneous, malicious, or fraudulent changes to programs or data and move those changes to production without Citizens' knowledge; data errors and system downtime may occur because of inadequate planning, testing, and review of changes; and changes to systems, programs, or data may not be known, understood, or reparable by anyone except the person making the change. In addition, without current contractual agreements, Citizens is unable to require these vendors to follow formal policies and procedures.

Citizens' management should implement procedures to ensure changes made to key programs and systems are appropriately authorized, prioritized, planned, developed, tested, reviewed, approved, and documented. In addition, management should require complete documentation of all reported problems and change requests, monitor the progress, and ensure timely and documented evidence of resolution. Management responded that all program changes are reviewed, tested, and approved before changes are made to the system; there were no unauthorized changes; and the LPMS policy management system does not provide adequate requirements for separation of duties (see Appendix A, page 14).

Additional Comments: Our review and testing of Citizens' procedures provided no evidence to support management's assertion that all program changes are reviewed, tested, and approved by Citizens.

If unauthorized changes have occurred, the lack of monitoring, inadequate segregation of duties, inadequate access controls, and lack of documentation would not allow for their detection. Therefore, Citizens' management cannot support its statement that there have been no such occurrences of unauthorized program changes.

Our review of the security capabilities within LPMS indicated that the system could support adequate requirements for separation of duties if Citizens' management dedicated adequate resources to properly configure the system.

Inadequate Controls for Securing and Monitoring Systems

Citizens has not implemented appropriate controls for securing and monitoring its systems. Good internal controls include policies for application security and availability requirements in response to identified risks; performing security monitoring and periodic testing to minimize and identify security weaknesses and incidents, as well as evaluating their potential impact; and developing and maintaining password requirements that would improve security over its systems.

Audit procedures identified the following weaknesses:

- Citizens has not configured its systems to ensure that login requirements for LPMS, Fiserv, and its internal network are adequately complex to help prevent inappropriate access. In addition, Citizens has not prohibited the sharing of user IDs and passwords.

- Citizens has not formally determined what data should be classified as sensitive and has not protected such data by using accepted security techniques.

- Citizens has not appropriately granted and monitored remote access to its internal network. No formal process exists for authorizing remote access, which leads to the lack of an audit trail.

- Citizens has not monitored logs within LPMS or Fiserv for unauthorized access to its systems or unauthorized changes to key financial data.

- Citizens has not implemented a security awareness program that would inform and train users regarding current information security risks.

Citizens' management has not placed sufficient emphasis on information security. Citizens has not committed resources to sufficiently manage password changes, monitor its networks, and identify and protect sensitive data. Without proper controls for securing and monitoring its systems, Citizens' systems may be susceptible to unauthorized access and changes, as well as theft or destruction of Citizens' data without detection. In addition, management may not be able to hold users accountable for unauthorized use of an ID.

Citizens' management should require that passwords for all systems meet industry standards for complexity, expiration, and login attempts and disallow the sharing of user IDs. Management should also establish a data classification policy to identify and protect sensitive data; ensure remote access is appropriately authorized and monitored; review access log reports for both Fiserv and LPMS on a regular basis to search for inappropriate or unauthorized changes to data; and implement a security administration function. Management described corrective action plans relating to implementing a new, more complex systems access process, adding levels of security to remote access and publishing formal written IT security policies. Management stated that Citizens does not capture sensitive policyholder data. It also expressed that remote access was limited to senior management and technical support (see Appendix A, page 15).

Additional Comments: Our review of Citizens' data shows that it does contain sensitive information.

Citizens could not provide evidence to support its statement that remote access to its systems was limited to only senior management and technical support.

Logs are not a means of controlling access to systems. Logs are a key detective control in which history is maintained for monitoring system activity. Because Citizens does not actively monitor access logs for unauthorized activity, Citizens cannot timely detect unauthorized transactions. Furthermore, without adequate controls and monitoring, neither Citizens nor the auditor can assert whether or not there were any unauthorized accesses or changes to data in Citizens' systems.

Lack of Contracts for Information Technology Services

Citizens did not have contracts in place during 2008 for services rendered by information technology vendors, I.T. By Design (ITBD) and I4 Integrated Services (I4). Citizens paid ITBD approximately $2.5 million and I4 approximately $558,000 for services between January 2008 and May 2009 without contracts for either vendor.

Good business practices, including those governing information technology, require contract expenditures to be paid based on the terms and conditions of an approved, written contract. In addition, the roles, responsibilities, and expectations between the contracting parties should be well-defined, and a process should be established to monitor service delivery to ensure that the vendor is meeting current business requirements and that performance is acceptable. Contracts with service organizations should include provisions to require the vendors to provide reports on policies and procedures placed in operation and tests of operating effectiveness in accordance with SAS No. 70 (SAS 70, Type II report).

Citizens did not take adequate measures to ensure that information technology service contracts were current and applicable to the ongoing business at Citizens after its separation from the Property Insurance Association of Louisiana (PIAL). The lack of contracts with information technology vendors prevents Citizens from measuring/monitoring the services provided by the vendors with deliverables included in a defined, agreed-upon service agreement. The lack of an agreement increases the risk that the vendor may make unauthorized changes to systems and data that are not in accordance with a mutually understood agreement. This further allows the vendors to have less accountability and exposes Citizens to a lack of recourse if vendors do not perform or perform improperly.

Citizens' management should develop written contracts with all of its information technology vendors and include a clause requiring a SAS 70, Type II report when the vendor is a service organization. Management noted that a valid contract was in place in 2008 for I4 and that ITBD was honoring and working with Citizens under the original PIAL contract (see Appendix A, page 16).

Additional Comments: Citizens had no current contract with I4 during 2008 and early 2009 to continue ongoing financial support services. The contract with I4 in effect in 2008 was to support the compilation of financial statements for previous years, and the contract had no provision for processing 2008 transactions or for the preparation of 2008 financial statements.

The contract between PIAL and ITBD is not a valid contract between Citizens and ITBD. In addition, the services provided to PIAL according to the terms of that contract are not the same services provided to Citizens. For example, the Statement of Work in the PIAL contract addresses the implementation and maintenance of only PIAL's "network" and has no provision for ITBD's continued support of the LPMS "application."

Without valid contracts, Citizens exposes itself to a lack of recourse if vendors do not perform or perform improperly and reduces vendor accountability.

Inadequate Documentation of Information Systems

Citizens does not have adequate current documentation on the design and functions of its critical IT systems. The IT systems were developed by vendors specifically for Citizens, including the LPMS, Datamart, and ORBS. In addition, Citizens' management and personnel are critically dependent on vendors to manage, operate, and maintain LPMS and Datamart because of a lack of knowledge transfer between the vendors and Citizens. LPMS is Citizens' main system for supporting its insurance operations. Citizens uses the vendor-developed Datamart as a method of obtaining data from LPMS to develop its manual general ledger entries. ORBS is another vendor-developed system used by Citizens to independently balance and reconcile LPMS data to the Datamart.

Although Citizens is very dependent on its vendors for its IT systems, the vendors were not required to obtain SAS 70 (service organization) audits to provide Citizens with some assurance that adequate controls were in place for those contractors. In fact, management did not have current contracts with these vendors. The primary vendor maintaining LPMS has refused to sign a contract. Efforts to sign a contract with this vendor only appear to have been made after the auditor brought the issue to Citizens' attention. The lack of current contracts means that the vendors could abruptly stop providing services and Citizens would not be able to manage its own data.

Control and management objectives over IT systems require that software should be developed in accordance with design specifications, development and documentation standards, quality assurance requirements, and approval standards and that a management plan should be implemented and include documentation of the roles, responsibilities, procedures, documentation requirements, appropriate systems documentation, and guidance that is appropriate for personnel with varying levels of skills and experience. Also, critical reliance on vendors for basic system knowledge should be minimized.

Citizens' staff could not provide the auditors with updated or complete documentation of LPMS, Datamart, and/or ORBS, which are key systems relied on for internal control over financial reporting. Citizens has no process in place with regard to the production of user documentation, operations manuals, and training material for LPMS, Datamart, or ORBS. Also, there are no current data dictionaries for LPMS or Datamart on hand.

- The technical LPMS manual provided to the auditor has been a "draft" version since 2005 with no evidence of management review, edit, or approval. In addition, Citizens lacked current documentation explaining security roles and profiles and their appropriate assignments to users in LPMS.

- The original documentation given to the auditor for the Datamart consisted of a "Process Flow Diagram" flowchart that was over 1½ years old. The flowchart did not represent the current configuration of the Datamart for 2008.

- The ORBS executive and project overviews and related database table schematics do not accurately portray the current use of the ORBS database.

Citizens has not adequately trained its IT personnel to manage, operate, and maintain LPMS or Datamart without substantial vendor assistance. The lack of documentation and knowledge of its own systems, as well as no contracts, leaves Citizens vulnerable to losing control and availability for those information systems in the event a vendor no longer agrees to provide services to Citizens.

Without proper system documentation and knowledge, Citizens may be unable to determine the nature of data, IT controls, or programs that are critical for its financial reporting needs. As a result, the IT function may not adequately support the financial reporting process and financial reporting errors could likely occur and remain undetected.

Without proper system documentation and knowledge, especially on highly customized systems such as these, systems are subject to errors because:

- Certain control points and specific tables/data are not identified.

- Risk assessments and vulnerability assessments have not been adequately performed.

- A transfer of knowledge and training has not occurred.

- Output and reports are not sufficiently defined.
- Security roles, profiles, and their appropriate assignments to users have not been clearly interpreted or maintained.
- Data could be manipulated without management's knowledge by both the vendor and Citizens' staff who have inappropriate access.

Citizens' management should develop a process and dedicate the necessary internal resources for maintaining up-to-date system documentation, such as operation manuals, training materials, data dictionaries, and other documentation. Management should also provide training to its personnel sufficient to keep LPMS and Datamart operational in the event vendors no longer provide their services. Citizens' management should ensure its vendors maintain proper internal controls and current, detailed documentation on all systems and related changes. This documentation should be readily available to necessary Citizens' personnel, auditors, and other appropriate individuals. Current contracts should be obtained for all vendors and SAS 70, Type II audits should be required for all vendors who are service organizations. Management concurred that system documentation was inadequate. Management expressed that it would not be prudent to use Citizens' personnel to document systems that are scheduled to be replaced (see Appendix A, page 17).

Additional Comments: Because LPMS will be used until 2011, management's lack of documentation of its information systems creates a risk that system errors could occur and remain undetected and/or unresolved. In addition, without proper documentation, the knowledge and understanding of Citizens' personnel of its own systems is hampered.

At the onset of the audit, we asked for all contractual agreements. Management did not inform us of any ongoing negotiations with ITBD, a vendor that provides critical services. In late July 2009, Citizens' personnel provided us a "DRAFT" of a proposed contract, which remained unsigned in November 2009.

The documentation supporting the Datamart was outdated and inadequate for use in gaining an in-depth understanding of the Datamart's current system configuration.

Lack of Information Technology Policies and Procedures

During 2008, Citizens lacked the following policies and procedures concerning its use of IT:

- A logical access policy with standardized procedures for the issuance, revocation, and periodic review of system and network user IDs
- A physical access security policy
- A policy that classifies data for confidentiality, integrity, availability, and retention requirements

- An acceptable usage policy defining appropriate business use
- A network policy and "remote access" policy for granting outside users access to the internal network
- A policy for IT procurement

According to *Control Objectives for Information and Related Technology* published by the IT Governance Institute, entities should:

- Develop and communicate policies and procedures to ensure the achievement of IT objectives and awareness of business and IT risks.
- Establish and maintain IT security roles and responsibilities.
- Establish data ownership, define appropriate security levels and protection controls, and define data retention and destruction requirements.
- Develop and follow a set of procedures that is consistent with the organization's overall procurement process to acquire needed IT-related infrastructure, hardware, software, and services.

Management has not placed sufficient emphasis on the creation and enforcement of IT policies and procedures. Without appropriate IT policies and procedures, there is an increased risk that management (1) may grant inappropriate access to its systems, data, and physical assets; (2) is not effectively managing and safeguarding the confidentiality, integrity, and availability of data; and (3) may not timely and cost-efficiently acquire IT services and/or equipment. In addition, inadequate IT policies and procedures could also result in a lack of recourse if a negative event would occur.

Citizens' management should develop, implement, and follow appropriate IT policies and procedures and make them available to appropriate Citizens' personnel. Management expressed that Citizens does have IT policies and procedures and is in the process of strengthening and documenting those IT policies and procedures (see Appendix A, page 18).

Additional Comments: Citizens' personnel neither provided us with formalized IT policies and procedures nor were its informal policies clear and consistently applied.

Management's Corrective Action Plans and Responses to the Findings and Recommendations

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Thursday, November 19, 2009

Steve J. Theriot, CPA
Legislative Auditor
State of Louisiana
1600 North Third Street
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

Re: Louisiana Citizens Property Insurance Corporation Response to Legislative Audit November 11, 2009 Letter - Audit Finding: Lack of Controls for Over Administering and Monitoring User Access

Dear Mr. Theriot:

LPMS - LCPIC agrees that the Consulting - SBS role is too broad and has eliminated all but three users for which two have new limitations for correcting policies. Three of the user names are needed for systems administration purposes (backups, LPMS system and CatLoss). Additionally, although the Consulting – SBS ID's were "valid", many did not have sign-on capabilities.

It is important to note that although we are taking measures to increase our system controls, LCPIC has never had any unauthorized access or changes made to our systems noted by LCPIC IT or the Legislative auditors.

Fiserv - Job descriptions and needs have been reviewed and access has been reduced to four people with full access and five people with limited access.

As has been well documented, due to system problems and the aftermath of the 2005 storms, in mid 2008 LCPIC still had not been able to complete financials for the years 2005, 2006, and 2007. One of the biggest issues that prohibited the completion of the financials was the reconcilement of bank accounts for the thousands of checks written after the 2005 storms. External consultants as well as all available internal personnel were provided system access to help reconcile the bank accounts.

As part of the new system installation, LCPIC has established a role for system administrator and will develop written policies regarding system access by the first quarter of 2010.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

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1600 North Third Street
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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit December 6, 2009 Letter - Audit Finding: Lack of Monitoring Over Service Providers

Dear Mr. Purpera:

LCPIC concurs in part with the finding. LCPIC does not have SAS 70 Type II reports from service providers contracted during 2008. The service provider selection process initiated in 2004, and administered through the Louisiana Office of State Purchasing, did not require audited financial statements or SAS 70 reports. This continued to be true in the 2009 Louisiana procurement process and was not a requirement for the 2009 service provider selection process. During 2008, all service providers were required to provide audited financial statements and two of the service providers, those with out of state administrative capability and not impaired by hurricanes Gustav and Ike, provided or had available for review SAS Type I reports.

LCPIC operating procedures include ongoing reviews of general and catastrophe claim files. LCPIC has procedures in place to perform operational reviews of service providers and performance requirements continue to be strengthened. Operational reviews were initiated in 2007, and reviews were conducted in 2007, 2008 and 2009. Operational reviews were conducted by Citizens staff and independent review staff, during this review period. Examples are attached.

LCPIC fully concurs with the need for continuous improvement and accountability in service provider controls and presented revised comprehensive claim and underwriting reviews to the LCPIC Board of Directors in August of 2009 (attached).

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Tuesday December 15, 2009

Daryl G. Purpera, CPA, CFE
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1600 North Third Street
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit November 30, 2009 Letter - Audit Finding: Inadequate Loss Reserve Development Process

Dear Mr. Purpera:

LCPIC absolutely does not concur with this finding. It is clear the auditor does not understand property casualty insurance reserving practices. Most of the information cited by the auditor is based on information only available after the fact. The auditor does not understand the development and purpose of the "incurred but not reported" portion of loss reserves. The auditor does not understand claim handling and the reserving process and is asserting misinformation despite many explanations. It is clear the examination was of individual pieces without understanding the entire process. The result is a waste of time and effort.

Regarding class action law suits, at 12/31/08, LCPIC had a settlement of the Orrill class and had $20 million on file with the court. This was reflected in the 2008 financials. The settlement of the Orrill class, by law, eliminates the other classes. This was the LCPIC position at the end of 2008, and continues to be the position as LCPIC goes through the appeal process. Evidence to this effect was provided to the auditors. LCPIC believes the case and IBNR reserves are adequate to settle all other pending suits and claims.

Regarding specific points raised:

1. This demonstrates a complete lack of understanding of claim handling and the establishment of case reserves. First, the payments were made after the end of 2008, so this is information that clearly was not available at year end 2008. The claim process is meant to pay claims and case reserves are adjusted according to company guidelines. The reserve is always different than the final payment. In fact, many insurance companies do not develop case reserves, instead, they use bulk or factor reserves.

The three bullet points listed by the auditor are typical of any insurance company operation and do not have an impact on the overall reserve process. This was explained to the auditors many times.

2. The reserves listed are included in the "Incurred but not Reported" portion of the overall loss reserves. There have always been manual commercial claims without case reserves. These are included in the payment patterns and are included in the overall actuarial reserve process.

3. This is a typical situation that relates to timing and again reflects the auditor's lack of knowledge of property and casualty claim and reserve practices.

4. This is a misclassification of a very small amount. It has no impact on the accuracy of the overall reserving process.

5. Lawyers do not set reserves for insurance companies. Again, this reflects the auditor's lack of understanding of the property and casualty reserving process. This information was obtained from the lawyers eleven (11) months after the fact and has no impact on the overall 2008 reserve calculation. As explained to the auditor many times, and as this finding demonstrates, after the fact, some cases close below the case reserve and some cases close above the case reserve.

In conclusion, LCPIC totally disagrees with the audit finding that LCPIC information systems and claim reserve procedures are inadequate to insure complete and accurate loss information. At the end of 2008, LCPIC had net Loss and LAE reserves of $170 million which was in the range of a detailed analysis conducted by an independent outside property and casualty actuarial firm.

Sincerely,

J. John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit November 30, 2009 Letter - Audit Finding: Noncompliance with State Eligibility Requirements

Dear Mr. Purpera:

LCPIC concurs with this finding. The LPMS policy management system does not provide the capability to monitor the denial of coverage requirement for new policies, or the capability to restrict agents from selling polices to people without evidence of denial.

The new policy management system that will be installed in the spring of 2010 will prohibit the issuance of new policies to property owners that have not been denied coverage by another insurance company.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit November 30, 2009 Letter - Audit Finding: Uncertainty in Premiums Receivable

Dear Mr. Purpera:

LCPIC does not concur with the wording of "uncertainty" in this finding. There are some issues within the LPMS system that impact premium receivable balances. Although the issues increase the difficulty of reconciling premium receivable, the impacts have been quantified and have minimal impact on overall receivable balances. Three were noted in the finding.

The first exception noted totaled $960,345 and was corrected in March of 2009.

The second exception noted impacted 850 out of 140,000 policies and has minimal dollar value. Any adjustments required will be made to our accounts receivable balance.

The final exception noted relates to another finding regarding the over/under collection of Emergency Assessments. The LPMS system did not make adjustments to Emergency Assessments receivable for changes made to policies in 2008. The differences have been quantified to be approximately $220,000. A balance sheet adjustment will be made between accounts receivable and accounts payable to correct this issue.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 18, 2009

Daryl G. Purpera, CPA, CFE
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Baton Rouge, Louisiana 70804-9397

Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit December 16, 2009 Letter - Audit Finding: Inaccurate and Incomplete Annual Fiscal Report

Dear Mr. Purpera:

LCPIC concurs in part with this finding. The accounting issues and challenges of LCPIC are well documented. As a result of the major storms in 2005 and system issues, as of June 2008, LCPIC did not have completed financials for 2005, 2006, or 2007. In the last six months of 2008, LCPIC was able to complete the 2005, 2006, and 2007 financial statements and work with outside auditors to complete the audits for these years. At the end of 2008 the LCPIC accounting efforts shifted to the completion of the 2008 financials. During 2008, the efforts of the LCPIC accounting staff were focused on completing the statutory accounting statements used by all insurance companies and required by the Louisiana Department of Insurance.

There are some differences in the rules of statutory accounting and presentation as compared to governmental GAAP reporting. Many of the issues raised by the Legislative Auditor relate to the different accounting treatments and presentation formats of governmental GAAP reporting versus insurance statutory reporting. LCPIC appreciates the efforts of the Legislative Auditor to assist us in reporting the GAAP financials in the proper format and will make the suggested changes to our governmental GAAP financial statements in 2008 and future years.

The Legislative Auditors have also suggested a few correcting entries to our accounting numbers and we have reviewed these and agree with their suggestions. LCPIC accounting had already made the $960,344 correcting entry in March of 2009 and will incorporate the $3,894,557 assessment correction into the prior period assessment accounting adjustment, as agreed upon with the Louisiana Department of Insurance in the 2009 statutory financial statements. As noted above, all other GAAP presentation and financial corrections will also be made by LCPIC.

LCPIC does not concur with the inferred lack of accounting effort, expertise, or supervisory process as noted in the finding. In 2009, for the first time in the history of the company, LCPIC filed all quarterly financial statements on time. For the first time in the history of the company, LCPIC is now producing monthly financial statements that are reviewed with our Board of Directors and annual budgets that are approved by our Board of Directors.

We believe that we made great accounting progress in 2008 by completing four years of financial statements, but do appreciate the suggestions from the Legislative auditor to improve the accuracy and presentation of our GAAP accounting statements.

Sincerely,

J. John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Monday December 7, 2009

Daryl G. Purpera, CPA, CFE
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1600 North Third Street
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

Re: Louisiana Citizens Property Insurance Corporation Response to Legislative Audit November 20, 2009 Letter - Audit Finding: December 2008 Rate-Filing Did Not Comply With State Law

Dear Mr. Purpera:

As stated in our response to the Rate-Filing Audit conducted by your office dated May 13, 2009, LCPIC concurs in part to the findings noted in the audit. We agree that the Citizens Board needs to review and approve rates and rating formulas prior to their effective date. However, in our response to the May 13, 2009 audit, we noted that we do not believe the Statute specifies an order for the approvals required from the Department of Insurance and our Board of Directors. In this case, we received approval from our Board of Directors three months prior to the implementation of the noted rate changes.

We disagree with the statement in your finding that "the Commissioner notified Citizens management that he would not approve the actuarially indicated rates because of pervasive data integrity issues" in the actuarial analysis. The issue the Commissioner's office had with our historic data was that at the time of the rate filing, the audits of our historical financial data had not been completed. The Commissioner's concern was using unaudited data in the actuarial analysis - not that we had "pervasive data integrity issues". In fact, the completed audits found no issues with our financial data. Since audited historical data was not available for the actuarial analysis, it was deemed that the market data should be relied upon for the rate analysis.

Citizens used the market survey data collected by the Department of Insurance because there was not enough time for Citizens to collect our own market data before the rate analysis was due.

We agree that Citizens should collect the market data for all future rate increases and have done so for the actuarial and rate analysis that is currently under way. A formal presentation was made to the LCPIC Board of Directors on August 13, 2009 on the rate making process. We also agree that the Citizens Board should not only approve any rate changes, but also the rate formulas that drive the rate changes.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

Daryl G. Purpera, CPA, CFE
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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit December 6, 2009 Letter - Audit Finding: Noncompliance with Policy Take-Out Program Requirements

Dear Mr. Purpera:

LCPIC concurs in part with this finding. LCPIC acknowledges that one non-admitted company and one company that did not have a rating were allowed to participate in the take out process in 2008.

However, LCPIC's process ensures that all statutory requirements are met to the greatest extent possible, without compromising compliance with LRS 22:23. Ultimately, LCPIC believes the process complies with the intent of LRS 22:2314. The objective of the LCPIC depopulation program is to allow the maximum number of policies to be depopulated.

With regard to the requirement that policies be bundled in groups of not less than 500 policies, note that all active policies were offered for depopulation in one large bundle of over 500 policies reflecting the geographical and risk characteristics of the overall book of business. This approach was chosen to comply with LRS 22:23, which gives the agent of record the ultimate authority to authorize the movement of a policy to a take-out company. If LCPIC were to select the policies assumed by each insurer, it would be a violation of that statute. LCPIC firmly believes that LRS 22:23 does apply and that, in this respect, there is a statutory conflict between LRS 22:23 and LRS 22:2314. LCPIC will work with the State Legislature to amend the take-out legislation in order to avoid any statutory conflicts.

The 75,683 policies referenced in the finding, includes policies requested by multiple companies. There were 60,000 unique polices requested and of those, the agents authorized 39,936 (66%) for transfer to the take out companies.

The LCPIC Board of Directors has formally approved the Depopulation process. Additionally, during each round of Depopulation, the Board members are advised on a monthly basis as to the names and number of companies participating, the policies requested, and the policies authorized to each company by the agent of record.

The Depopulation process has been extremely successful for the state of Louisiana. In 2008, LCPIC reduced its policy base by 40,000 policies (25% of its book of business), reducing the total insured value of the company be approximately $9 billion, thereby reducing the risk of future assessments to all property insurance policyholders in the state.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit December 9, 2009 Letter - Audit Finding: Inaccurate Calculation of Emergency Assessment on Premium Changes

Dear Mr. Purpera:

LCPIC concurs in part with this finding. In 2007, a change was made to the LPMS system to charge the required 5% Emergency Assessment on all new and renewal polices in 2008. A systems change was also made to refund Emergency Assessments when policies were cancelled flat. However, systems issues remained within the LPMS system for recalculating Emergency Assessments for changes made to existing policies. These issues were corrected in early 2009.

The impact of the Emergency Assessment calculation error was quantified to be approximately $220,000. All Emergency Assessments collected were remitted to the bond trustee, even if they were in error, as required by statute.

Sincerely,

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

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1600 North Third Street
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit December 6, 2009 Letter - Audit Finding: Lack of an Internal Audit Function

Dear Mr. Purpera:

LCPIC concurs in part with this finding. While LCPIC does not have an official internal audit function, LCPIC has made great progress in developing formal written policies and procedures and internal controls. Prior to April 1, 2008, LCPIC outsourced all management functions to Property Insurance Association of Louisiana (PIAL). LCPIC officially assumed all management functions on April 1, 2008. LCPIC hired an executive management team that was tasked with solving significant operational issues. In addition, LCPIC managed 55,000 Gustav/IKE storm claims in 2008. As a part of the solution to the operational issues the current management team inherited, LCPIC developed and documented multiple operational processes and internal control procedures in 2008.

LCPIC believes the development and documentation of formal processes and procedures and internal controls, has provided an internal audit aspect for the company. However, in order to improve operational and internal controls in 2010, LCPIC will develop and execute specific tests of company operational and internal controls.

LCPIC will continue to examine the benefits of hiring personnel for a formal internal audit function with the costs that ultimately are paid by the property insurance policy holders of the state.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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November 9, 2009

Steve J. Theriot, CPA
Louisiana Legislative Auditor
1600 North Third Street
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Theriot:

Please find our responses to the audit findings noted below:

Audit Finding: Inadequate Program/System Change Controls

Our process is that all program changes are reviewed, tested, and approved before changes are made to the system.

While many things fall into the category of "may be possible", including unauthorized program changes, any unauthorized changes would create system issues and or questions that would be immediately investigated. Although unauthorized program changes are theoretically possible, there have been no such occurrences.

The LPMS policy management system does not provide adequate requirements for separation of duties; however, we are in the process of replacing this old system before the end of 2010. Our new policy management system will require adequate separation of duties.

Sincerely,

John Wortman

J. John Wortman
CEO
Louisiana Citizens Property Insurance Corporation

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Thursday, November 19, 2009

Steve J. Theriot, CPA
Legislative Auditor
State of Louisiana
1600 North Third Street
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

Re: Louisiana Citizens Property Insurance Corporation Response to Legislative Audit November 6, 2009 Letter - Audit Finding: Inadequate Controls for Securing and Monitoring Systems

Dear Mr. Theriot:

LCPIC believes the lack of system access complexity is compensated by requirements to have multiple sign-ons to access our systems. However, we are in the process of implementing a new, more complex systems access process that will be completed in the first quarter of 2010. Implementation was impacted by the time it took to move from the old PIAL domain to the Citizens domain (official separation was in 4/08). Generic names have been removed.

All financial data sent to outside vendors is encrypted. LCPIC does <u>not</u> capture sensitive policyholder data such as social security numbers or bank account information.

Remote access is limited to a small group of users (senior management and technical support). In the first quarter of 2010 we will eliminate VPN (remote access) and move to terminal services which will add additional levels of security.

LCPIC believes there are many ways to control system access other than logs. Our systems access and the ability to make changes is controlled via access parameters as noted above. All transactions leave an audit trail and record the user. There have been no known instances found of unauthorized system access or changes noted by either LCPIC or by the auditors.

Formal written IT security policies will be published to all users during the first quarter of 2010.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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November 9, 2009

Steve J. Theriot, CPA
Louisiana Legislative Auditor
1600 North Third Street
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Theriot:

Please find our responses to the audit findings noted below:

Audit Finding: Lack of Contracts for Information Technology Services

LCPIC has a valid contract with I4 that was signed on December 6, 2007 and was in effect in 2008.

Our primary usage of the vendor IT By Design (ITBD) is for maintenance of our LPMS policy management system. ITBD had a written agreement for services with PIAL prior to April of 2008 when LCPIC formally split from PIAL. Although the formal contract with ITBD was not officially transferred in April of 2008, both LCPIC and ITBD have been honoring and working under the original contract. We agree that it would be better to have a new contract between LCPIC and ITBD and are in formal contract negotiations with ITBD at this time. However, the negotiations have been complicated because both parties understand we will be phasing out our use of ITBD with the implementation of our new policy management system in 2010. We have a very detailed and formalized contract with the vendor for our new policy management system (West Point Underwriting). We will have a signed contract with ITBD by January 1, 2010. Dan Laffey, our CIO, and Paige Harper, our Corporate Council, are managing the contract negotiations with ITBD.

Although the contract negotiations with ITBD have not been finalized, there have been no instances of ITBD making unauthorized changes to the LPMS system. All system changes go through user acceptance testing and approval before implementation.

Sincerely,

John Wortman

J. John Wortman
CEO
Louisiana Citizens Property Insurance Corporation

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November 9, 2009

Steve J. Theriot, CPA
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1600 North Third Street
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Baton Rouge, LA 70804-9397

Dear Mr. Theriot:

Please find our responses to the audit findings noted below:

Audit Finding: Inadequate Documentation of Information Systems

We agree that the documentation of our LPMS policy management system is inadequate. However, as the auditors know, we are in the process of replacing the LPMS policy management system. We do not believe it would be prudent to utilize our personnel or incur the financial cost to document a system that we are actively replacing. Our new policy management system (EPIC) will be fully documented.

We enlisted the State of Louisiana Purchasing Department to help us purchase our new policy management system. The requirement for the vendor to be SAS 70 compliant was not a part of the state process; however, we concur with the audit advice and will make this an important element of all future IT contracts.

The audit comment that the primary vendor for our LPMS system has refused to sign a contract is not true. We are currently, and were in active contractual negotiations with ITBD before the audit began. We do not understand why the auditor would state that he brought up the issue since we provided the auditor with a draft copy of the proposed contract. The efforts to formalize a contract with ITBD began in January 2009, well before the beginning of the audit.

We concur that we need to increase our written IT documentation, and are in the process of doing so. We are spending our efforts and resources to ensure our new system is documented. We are not expending resources to document a system that we are in the process of replacing. LPMS and ORBS will be phased out over the next 15 months.

We do have written documentation for Data Mart, but will update it to make sure it is current. Our review will be led by Dan Laffey and will be concluded by January 1, 2010.

Sincerely,

John Wortman

J. John Wortman
CEO
Louisiana Citizens Property Insurance Corporation

LOUISIANA CITIZENS
Property Insurance Corporation

433 Metairie Road, Suite 600
Metairie, LA 70005-4385
Phone 504.831.6930
Fax 504.831.6676
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November 9, 2009

Steve J. Theriot, CPA
Louisiana Legislative Auditor
1600 North Third Street
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Theriot:

Please find our responses to the audit findings noted below:

<u>Audit Finding: Lack of Information Technology Policies and Procedures</u>

LCPIC does in fact have IT policies and procedures. The issue noted is that we need to increase the formal written documentation of our policies and procedures. We are in the process of strengthening and documenting our IT policies and procedures. Dan Laffey, LCPIC CIO, is leading the effort and anticipates the project will be completed by the end of May 2010.

Sincerely,

John Wortman

J. John Wortman
CEO
Louisiana Citizens Property Insurance Corporation

The following document is an additional response prepared by Louisiana Citizens Property Insurance Corporation management.

It is not an integral part of the Legislative Auditor report. It has not been subjected to audit by the Legislative Auditor

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Tuesday, January 19, 2010

Daryl G. Purpera, CPA, CFE
Temporary Legislative Auditor
State of Louisiana
1600 North Third Street
Post Office Box 94397
Baton Rouge, LA 70804-9397

Re: Louisiana Citizens Property Insurance Corporation
Draft 2008 Audit delivered to us December 21, 2009

Dear Mr. Purpera:

By way of background, what today is known as the Louisiana Citizens Property Insurance Corporation began in 1970 as the FAIR and Coastal Plans of Louisiana. The FAIR Plan was the market of last resort for personal and commercial property insurance above the Intracoastal Waterway. The Coastal Plan was the market of last resort for property insurance written on locations between the Gulf and the Intracoastal Waterway.

The first policies were written in 1970 and the service provider was Audubon Insurance Company, a Louisiana domiciled property and casualty insurance company. Audubon Insurance was purchased by AIG in 1982; however, it continued to be the service provider for the Coastal and FAIR Plans. The FAIR and Coastal Plans had insurance industry controlled boards of directors and plan administration was provided by the Property Insurance Association of Louisiana.

After unsuccessful attempts to sell Audubon, in the early 2000's AIG decided to shut down Audubon's underwriting operation; but, at least for the short term, maintain the servicing carrier operation.

Because of concern regarding the ongoing servicing carrier direction of Audubon/AIG, in 2002 the managers of the FAIR and Coastal Plans made a decision to appoint multiple servicing carriers and to build a single policy management system that would be used by all servicing carriers. In late 2002 a decision was made to hire SBS, a Baton Rouge software company, to build the new policy processing, claim and accounting system.

In 2003, the Louisiana Legislature passed a bill that established Louisiana Citizens Property Insurance Corporation as the organization that would be the market of last resort for property insurance in Louisiana. A Citizens board of directors was established and the Property

Insurance Association of Louisiana continued to manage the affairs of the newly created property residual market. At the time, this seemed the most appropriate route as no funds were appropriated by the state to establish a Citizens organization.

The Citizens board of directors decided to continue the direction of the old FAIR and Coastal Plans in the following areas:

- Build its own policy management system
- Prepare a request for bids to engage multiple service providers

In early 2005 proposals for servicing carriers bids were requested. Three organizations were awarded three year contracts from April of 2005 to April of 2008. The selected service providers were Bankers Insurance Company, First Premium, and the MacNeill Group.

Some of the unsuccessful bidders were unhappy with the result and brought suit to have the contracts re-bid. This attempt was unsuccessful; however, it delayed the implementation date until October 1, 2005. The new policy management system (LPMS) was also scheduled to be installed on October 1, 2005.

In the late summer of 2005, within one month of each other, hurricanes Katrina and Rita struck the Louisiana coast. These events created great hardships for the Citizens organization as many employees were impacted individually and, while the Metairie office was opened within thirty (30) days, it was over eight months before normal operations could be re-established. Temporary offices were established in Baton Rouge and the resources of PIAL, Audubon, and the new service providers focused on the tactical issues of locating claimants, settling claims, processing policies and handling customer service issues. The system did not work properly and over 40,000 checks were issued manually.

By early 2006 Louisiana Citizens had run out of funds to pay Katrina and Rita claims. All checks were put on hold as the company raised $1 billion in debt. The bond issues were closed in early March and the company again began paying claims.

It became apparent that while the LPMS system was able to produce quotes, policies, cancellations and policy changes, the system could not aggregate data so LPMS was unable to build management and financial reports. Efforts to work with SBS to fix the issues were unsuccessful and in November of 2006 SBS was replaced on the project with another Baton Rouge software vendor, IT by Design.

In late 2006 the Citizens Board of Directors became more aware of the financial and operating issues and the firm of Bostick and Crawford was hired to first, clearly define the issues and second, bring recommended fixes to the table. Their conclusion, presented to the board in early 2007, stated, in summary, the auditable data and proper management information could possibly be retrieved from the system; however, it would take considerable time and substantial additional resources. The review also pointed out the following:

- The LCPIC independent auditors had withdrawn from the engagement
- The CEO and CFO of PIAL had resigned
- Both the automated and manual accounting systems were found to be incapable of producing the information needed to complete financial statements as of December 2005 or 2006
- The data center was unsecured and highly exposed to disasters, data backup and recovery plans were ineffective and general security was a significant problem

In the spring of 2007 the board made a decision that Citizens should begin to hire its own management team. Prior to this time, Citizens had never employed anyone as all operations had been outsourced to the Property Insurance Association of Louisiana and the CEO of PIAL was also the CEO of Citizens. This decision was implemented in late April of 2007 when John Wortman was hired as CEO of Citizens. In late May, Mark Brockelman was hired, on an interim basis, as CFO of Citizens. On July 30, 2007 Dan Laffey was named CIO. The remaining members of the management team were hired in 2008.

The LCPIC executive team's charge is to build Louisiana Citizens Property Insurance Corporation (LCPIC) into a quality organization. This is following the greatest natural disaster recorded in the history of the United States; Hurricane Katrina, which was closely followed by Hurricane Rita. As LCPIC continues to move to achieve this objective their direction has been recognized by insurance experts and laymen and LCPIC has enjoyed favorable national recognition.

In December of 2007 LCPIC made detailed presentations to the Legislative auditor and outside audit firms as LCPIC worked with the Legislative Auditor's office to release a RFP to engage an outside auditor to complete the audits for 2005, 2006, and 2007. An award was made in early 2008 to engage the LaPorte firm to do the audits for the three years. These audits were completed as follows: 2005 in April of 2008, 2006 in July of 2008 and 2007 in October of 2008. The 2005 and 2006 Income Statements, Balance Sheets, and Cash Flow Statements were "qualified" since current management was not in place during those years and, therefore, no management representation letter could be produced. The 2007 Income and Cash Flow Statements were "qualified" for the same reason. The 2007 Balance Sheet was not "qualified" as a management representation letter could be produced as it was a 12/31/07 point in time statement.

On January 16, 2009 LaPorte presented an engagement letter to complete the 2008 audit. The four key elements of the letter were as follows: They had quality experienced people to complete the audit, their estimated time frame was ten (10) weeks, their start date would be 3/9/09, and their costs would be no more than $130,000. This letter was forwarded to the Legislative Auditor on January 20, 2009.

After several follow up conversations with the Legislative Auditor, on March 9, 2009 LCPIC received an engagement letter from the Legislative Auditor stating that they would do the audit. The four key elements of their letter were as follows: They had quality, experienced people to complete the audit; they would begin the audit on 3/23/09; their estimated time frame was six (6) months; and their costs would be no more than $480,000. We subsequently obtained annual audit costs of eight (8) other residual market property insurance plans. Florida was the highest of the six at $200,000 to $250,000 and South Carolina was the lowest at $21,000. The other states were: California @ $85,000, Massachusetts and Rhode Island @145,000, Michigan @$75,000, New York @ $80,000, and Texas @160,000.

LCPIC met with the Legislative Auditor on 3/18/09 to review the timing, cost differences, and asked if they could accomplish a Statutory Audit for the LDI. The Legislative Auditor responded they would work as quickly and efficiently as possible to try and reduce costs and timing. Also, they said they could complete the Statutory Audit. It was agreed they would complete a work plan and they would conduct an entrance conference.

The entrance conference was held on May 27, 2009. This was over eleven (11) weeks after the date of the engagement letter (which was never executed) and nine (9) weeks after the announced start date.

The initial focus of the audit was on technology. After several months, the Legislative Auditor indicated there were issues with LPMS. LCPIC had pointed out these same or similar issues with LPMS to the Legislative Auditor in December of 2007 together with our plan to put in the short term fixes (DataMart and ORBS) while work was going on to replace the system with a new policy and claim processing system.

The Legislative Auditor met with senior management of LCPIC on 9/1/09 and indicated his staff had issues with LCPIC in that they were not getting information timely and there was a lack of cooperation by LCPIC. Also, the Legislative Auditor said he had been told there were issues with system performance and controls.

Internal discussions at LCPIC revealed that LCPIC staff was frustrated with issues such as: Little insurance knowledge on the part of the auditors, a combative attitude (especially the systems auditors), no interest or understanding of what had been accomplished at LCPIC, demonstration of a lack of trust with LCPIC employees, and a "divide and conquer" approach to the audit.

The first finding was presented on October 21, 2009. A summary of the fifteen (15) findings is enclosed as Exhibit A. This summary also includes Management Comments and Action LCPIC has taken or will take to address the finding.

Jerry Carlisle, Craig Le Bouef, Denise Brignac, Steve Cottrell, Dan Laffey, Vijay Ramachandran, and I met with you and members of your staff on 12/17/09 to review the findings. We understood your goal was to release the audit before the end of the year. Later, we agreed that the report would not be made public until the final report had been reviewed by the LCPIC Audit Committee and Board of Directors. You agreed to send us the final report on Wednesday, January 20, 2010 and agreed the report would be made public on Monday, January 25, 2010. .

LCPIC has made much progress in its operations since 2007. Some examples are as follows:

- Built a quality, experienced management team, from scratch
- On April 1, 2008 LCPIC separated from the third party (Property Insurance Association of Louisiana) that was managing LCPIC
- Built a warehouse (DataMart) to be able to aggregate data from the poorly developed policy and claim processing system LPMS
- Built a balancing system to assure proper financials (ORBS)
- From mid 2007 into 2008 LCPIC went through a process of reconciling every transaction (over 60,000) which was necessary to 'clean up' its books and develop financials
- Reconciled bank statements for 2005, 2006, and 2007
- Produced financials for 2005, 2006, 2007, and 2008
- Produced audited financials for 2005, 2006 and 2007
- Filed 2008 financials with the Louisiana Department of Insurance on time (first time ever)
- Refinanced $300 million auction rate bonds, saving taxpayers $15 million per year
- Worked with the Louisiana Office of State Purchasing to release a RFP for a new policy and claim processing system
- Made an award to West Point and we will begin to implement the new system 2/1/10
- Moved all servers in to a secure location (tier 4)
- Worked with the Louisiana Office of State Purchasing to release a RFP for service providers
- Made an award to Bankers Insurance Group and First Premium Insurance Group
- Developed a formal service provider underwriting and claim audit process
- Developed a formal planning and budgeting process
- Developed monthly financial reporting
- Developed a monthly management reporting system

- Worked with the Louisiana Insurance Department to build a formal depopulation process and worked with the private insurance sector to move over 40,000 policies from LCPIC to the private sector
- Handled over 55,000 hurricane claims (Gustav and Ike – August and September of 2008) with less than 500 open at this time
- Prudent financial management allowed LCPIC to weather the $325 million Gustav and Ike events with no assessment levied on the property owners of Louisiana

LCPIC still has challenges; the key areas are as follows:

- Complete implementation of the new policy and claim processing system (EPIC)
- Continue to improve workflow
- Finalize written documentation of workflow and control processes
- Continue to refine our website as a communication vehicle
- Continue to evaluate the LCPIC catastrophe plan
- Continue efforts to depopulate LCPIC policies
- Improve employee and agent training programs
- Continue to improve GAAP financial reporting
- Develop appropriate internal audit processes

Due to the timing of findings for the 2008 audit being delivered late in 2009, we understand that many of these same issues will affect the 2009 audit. The Board of Directors has recently reformed the Audit Committee of the Board and that Committee will take a more active role in the 2009 audit process. That role will include engaging the independent auditor to perform the statutory audit as well as monitoring progress throughout the audit process. We look forward to building a closer relationship with your organization as we continue to move forward.

Sincerely,

John Wortman

J. John Wortman, CEO

C: LCPIC Board of Directors
C: Steve Cottrell, CFO

2008 Legislative Audit of Louisiana Citizens Insurance

Finding Summary - Exhibit A

	Finding	Management Comments	Action	Finding Date	Requested Response	Response Date
1	Lack of Controls Over Administering and Monitoring User Access	User logs are in place. No instances of abuse.	User ID's have been examined and restricted to needed systems. Under new system, access better defined and documented. Increasing complexity of sign on processes. User access will be defined by "functional groups" in EPIC. Software purchased to ensure intrusion by any unauthorized party through the web - to be implemented by June 1, 2010.	11/11/09	11/25/09	11/19/09
2	Inadequate Program/System Change Controls	All changes are checked and tested before implementation. No evidence of abuse.	LCPIC will have change control processes developed (documented and implemented) for the new EPIC system by April 1, 2010. Additional work will be done to strengthen existing systems processes by June 30, 2010.	10/23/09	11/6/09	11/2/09
3	Lack of Monitoring Over Service Providers	Formal RFP with OSP. SAS 70 II not a requirement. Audit process began in 2007.	Agree we should strengthen our audit of the SP's. Implemented formal monthly audit process in 2009. Will work with Audit Committee to develop appropriate procedures.	12/6/09	12/11/09	12/11/09
4	Inadequate Loss Reserve Development Process	Totally disagree with this finding. Auditors do not understand insurance reserve practices.	We are developing a formal written reserve policy - will be complete by 4/1/2010	12/14/09	12/18/09	12/15/09

5	Inaccurate and Incomplete Annual Fiscal Report	Most of the findings were presentation differences between STAT and GAAP. Two ledger entries required, of which one was made in Q1 2009 before the audit started.	Have made all required entries and statement presentation changes and resubmitted 2008 GAAP financial statements. Will ensure LLA format is used for future GAAP submissions.	12/16/09	12/23/09	12/18/09
6	Uncertainty on Premiums Receivable	Some small issues (less than $1 million on a premium base of more than $250 million). Was corrected in 3/09 before audit.	Have developed a formal reconcilement process that will be applied to 2009 ending premiums receivable as part of the year end closing procedures.	12/6/09	12/11/09	12/11/09
7	Noncompliance with State Eligibility Requirements	Finding relates to verification of rejection by another insurance company, finding is correct	Current LPMS system did not provide a way to enforce this. We did not feel that additional manpower would be cost beneficial to ensure compliance with this requirement. New system will provide enforcement mechanism as of April 2010.	11/30/09	12/13/09	12/11/09
8	Dec 2008 Rate Filing did not Comply with Law	Repeat of May 13, 2009 rate audit Primary issue was validity of calculation of actuarially sound rates using unaudited data.	Financials have been audited and LCPIC is in compliance, in our judgement, with statutes.	11/20/09	12/8/09	12/7/09
9	Noncompliance with Policy Take-out Program Requirments	Disagree with LLA legal review. Conflicting statutes. Our program has been very successful. Depopulated more than 25% of our policies. ($68 million premium, $8.5 billion of insured value)	Will work with State Legislature to eliminate conflicts in the statutes in March 2010 session. Also, we will not allow non-admitted companies to participate in the future.	12/6/09	12/11/09	12/11/09
10	Lack of an Internal Audit Function	True, but we think this should have been a recommendation, not a finding.	Will work with the Audit Committee to develop proper levels of internal audit and determine feasibility and cost benefit relationship of hiring an internal auditor.	12/6/09	12/11/09	12/11/09

11	Inadequate Controls for Securing and Monitoring Systems	See Finding #1	Duplicate of Finding 1	11/6/09	11/20/09	11/19/09
12	Lack of IT Policies and Procedures	Have some policies, but need to increase documentation. No evidence of abuse	Will continue to improve and document policies and procedures. Intent is to build good documentation on "go forward" systems. The majority of the needed policies and procedures will be documented by May 1, 2010	10/21/09	11/4/09	11/2/09
13	Lack of Contracts for IT Services	Have some contracts, still working under other contracts that were put in place by PIAL	Working to ensure we have well written contracts and they are with LA Citizens. The IT by Design contract as well as the I4 contracts will be updated and in place by the April 1, 2010.	10/21/09	11/4/09	11/2/09
14	Inaccurate Calculation of Emergency Assessments on Premium Charges	Agree. Impact was $200,000. All assessments go to bond trustee No impact to state or financials.	Fixed in early 2009.	12/9/09	12/15/09	12/11/09
15	Inadequate Documentation of IS	Duplication of findings 2 & 12	See 2 & 12	10/23/09	11/6/09	11/2/09