

MEMO

INTERNAL AUDIT DIVISION

Keith L. Duckett, Director



175 Water Street - 14th Floor

New York, N.Y. 10038

Tel: (212) 458-3300

Fax: (212) 227-0127

TO: M.R. Greenberg

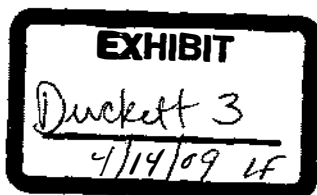
Date: May 5, 1999

RE: *Internal audit Report #99-45
New Hampshire Insurance Group &
AL Warranty Division*

During the course of the audit, there was a significant reorganization of the company. By the conclusion of the audit, the issues were attributable to a management team that was no longer in place. Although the issues were attributable to prior management, the resolution of these issues was and is vital to the successful management and control of the business going forward. Consequently, we spent a significant amount of time in discussions with the Lexington management team to ensure that they understood and agreed with the issues surfaced during the audit. I also had a concern that the new management team would be unfairly held accountable for issues which predated their management of the business. I thought it was prudent to give the new management team an opportunity to develop an action plan to address the issues and to include their plan with the audit report. This further delayed issuance of the report, but I think that the perspective was important. A major part of the implementation plan is contingent on automating the data feed between the MGA's and Lexington. The technology plan has only recently been developed and submitted for senior management approval. It is critical that manual procedures be implemented as a stop gap measure until the new technology is implemented. Management has included these manual procedures as part of their action plan.

In summary, most of the control enhancements are in the process of being implemented and a direct result of the issues identified during the audit. While the steps identified in the action plan should facilitate control improvements, we should allow the new procedures and processes to function for a few months in order to assess their adequacy and effectiveness. The IAD will perform a follow-up review in 6 months to assess the adequacy and effectiveness of these procedures.

A handwritten signature in black ink, appearing to read "K. Duckett".



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