View metadata, citation and similar papers at core.ac.uk

brought to you by CORE

provided by eGrove (Univ. of Mississippi)

University of Mississippi
eGrove

Industry Developments and Alerts

American Institute of Certified Public Accountants (AICPA) Historical Collection

1989

Property and liability insurance industry developments - 1989; Audit risk alerts

American Institute of Certified Public Accountants. Auditing Standards Division

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_indev

Part of the Accounting Commons, and the Taxation Commons

Recommended Citation

American Institute of Certified Public Accountants. Auditing Standards Division, "Property and liability insurance industry developments - 1989; Audit risk alerts" (1989). *Industry Developments and Alerts*. 160.
https://egrove.olemiss.edu/aicpa_indev/160

This Article is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Industry Developments and Alerts by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

CURRENT INDUSTRY DEVELOPMENTS

Property and Liability Insurance Industry Developments – 1989

Update to AICPA Industry Audit Guide *Audits of Fire and Casualty Insurance Companies*

Includes *Audit Risk Alert – 1989*

Issued by the Auditing Standards Division

AICPA
American Institute of Certified Public Accountants

NOTICE TO READERS

This document, which contains *Property and Liability Insurance Industry Developments—1989* and *Audit Risk Alert—1989,* is intended to provide an overview of matters that may affect audits of the financial statements of property and liability insurance companies, including recent economic, professional, and regulatory developments. This document has been prepared by the AICPA staff in consultation with the AICPA Insurance Companies Committee and members of the AICPA Auditing Standards Board. This document has not been approved, disapproved, or otherwise acted upon by a senior technical committee of the AICPA.

Patrick L. McNamee
Director, Audit and Accounting Guides

Copyright © 1989 by the
American Institute of Certified Public Accountants
1211 Avenue of the Americas, New York, N.Y. 10036-8775
1 2 3 4 5 6 7 8 9 0 AudS 8 9

Table of Contents

	Page
Property and Liability Insurance Industry Developments—1989	4
Property and Liability Insurance Industry Environment	4
Overall Risk Factors	5
Specific Conditions or Risk Factors	5
Regulatory, Accounting, and Reporting Developments	9
Audit Risk Alert—1989	13
Introduction	13
Expectation-Gap SASs	13
Applicability of SAS No. 63 on Compliance Auditing	15
Illegal Acts	16
Questionable Accounting and Fraudulent Financial Reporting	16
Highly Leveraged Companies (Including LBOs) and Holders of Junk Bonds	17
Loan Agreements	18
Specialized Industries	18
Recurring Audit Problems	19
Technical Hotline	20

Overall Risk Factors

Although conditions vary from company to company, the following are among the conditions specific to the property and liability insurance industry that affect the industry's overall audit risk:

- Historically cyclical underwriting patterns
- Widespread rate and product competition in both domestic and international markets
- Extensive use of estimates, as in determining loss reserves
- Social as well as economic inflation, such as increases in litigation or amounts of jury awards or settlements, and the resulting overall increase in claim costs
- The long-tail nature of the business, which is the lag between the occurrence, reporting, and settlement of claims
- The retrospective nature of certain revenue and expense determinations, such as in workers' compensation insurance
- The regulatory nature of the industry, which affects most of its functions
- The need for liquidity and adequate funds to pay policyholder claims from catastrophes or similar events
- The need to meet surplus requirements imposed by regulatory authorities
- Reliance on third parties, such as agents, brokers, insureds, reinsurers, loss adjusters, pools, syndicates, and underwriting intermediaries, for reporting information used in management and accounting systems
- The Tax Reform Act of 1986 and its impact on tax expense and net income

Specific Conditions or Risk Factors

This section describes certain conditions that may indicate (but that do not necessarily confirm) the existence of increased audit risk. The descriptions of these conditions are based partially on information contained in the *Troubled Insurance Company Handbook*, published by the National Association of Insurance Commissioners. This list is not all-inclusive.

Rapid Growth in Premium Volume

Rapid growth in premium volume, particularly in periods in which the industry's overall premium growth rate is slow, may indicate that the company is engaged in "cash flow underwriting"; that is, the company is keeping its premium rates low to maintain or increase its market share. The possible effects of excessive or uncontrolled growth in premiums may include the following:

- The company's surplus may not be sufficient to support the increased level of exposure.
- The company may not have adequate resources or expertise to properly administer the new business.
- The practice of "cash flow underwriting" may indicate inappropriate pricing or underwriting practices or inadequate loss reserving.
- The company may enter into nontransfer-of-risk reinsurance arrangements to avoid the statutory surplus strain associated with writing new business.

New Lines of Business

Rapid expansion into new lines of business or new geographic areas may indicate increased risk if a company does not have sufficient experience or qualified personnel to underwrite and manage the new business. In addition, a new company or a company entering a new line of business may not have developed sufficient relevant data by which to establish premium rates or estimate loss reserves.

Pricing or Underwriting Practices

Lack of adherence to sound pricing and underwriting policies may indicate increased audit risk. Sound pricing decisions require appropriate information and reasonable estimates of expected losses and expenses. The determination of premium rates based solely on rates charged by competitors may not adequately consider differences in the nature of the risks being insured. A lack of established underwriting policies, or the failure to observe established policies, may lead to the acceptance of unanticipated risks or the inappropriate pricing of those risks.

Reserving

Loss and loss-adjustment expense reserves generally are the most significant and the most subjective amounts in a property and liability

insurer's balance sheet. Inappropriate reserving may result inadvertently from a lack of sufficient expertise by the company's loss reserving personnel, a lack of sufficient understanding of the factors affecting the frequency or severity of losses, or poor judgment. Estimation of reserves is difficult because claims may not be reported, much less settled, until a future date and because the ultimate amounts of losses and related expenses may be affected by factors such as future inflation, negotiation, or court decisions. These difficulties in estimation become greater for long-tail lines of business, and in recent years, the "tail" for the industry in general has lengthened.

Appropriate loss reserving is based on the successive observation of historical and current loss-development data. Appropriate reserving also requires the use of loss-reserve projection methods that are appropriate in light of possible changes in circumstances and that properly consider developing trends in experience. Inadequate, incomplete, or inconsistent data can lead to inappropriate loss-reserve estimates.

Claims Management

Inadequate claims-management procedures or failure to observe established procedures can result in excessive or improper claim-settlement payments. Inadequate claims management also may result in unsound reserving if claims-settlement practices differ from those anticipated in the pricing of coverages or if changes in claim-settlement practices are not considered in estimating loss reserves.

Reinsurance

Reinsurance arrangements can be complex, and reinsurance contracts can be complicated documents. Adequate control over a company's reinsurance program requires that management have a knowledge and understanding of the reinsurance business and the financial effects of reinsurance. Likewise, the auditor should obtain an understanding of the principal terms of significant reinsurance contracts, the business objectives of the contracts, and the rights and obligations of the parties under the contracts. Additional guidance is provided in the AICPA Statement of Position (SOP), *Auditing Property and Liability Reinsurance*. The following is a summary of additional audit risk considerations related to reinsurance.

Ceded Reinsurance. A lack of an adequate reinsurance program may expose an insurance company to risks that can jeopardize the company's financial stability, particularly if the company's risks are concentrated geographically or by type of risk. In contrast, excessive reinsurance

coverage can significantly reduce a company's margins available to cover fixed and overhead expenses. Some industry analysts believe that the large catastrophic losses incurred by the industry in 1989 will result in higher renewal rates for reinsurance. Significant changes in a company's reinsurance program or retention limits ordinarily should be considered in evaluating estimates of loss reserves and reinsurance recoverables.

Uncollectible Reinsurance. The collectibility of amounts due under ceded reinsurance arrangements continues to be of concern to the insurance industry. Collectibility problems may arise if the assuming company becomes financially unsound. The AICPA SOP *Auditing Property and Liability Reinsurance* discusses ceding companies' controls to evaluate the financial stability of assuming companies. Collectibility issues also can result from assuming companies challenging or repudiating reinsurance claims based on disagreements over interpretations of contract terms or allegations that the ceding company has not fulfilled its obligations under the contract. Effective for 1989 statutory annual statements, ceding companies may be subject to significant reductions to reported statutory surplus if significant balances due from authorized reinsurers on paid losses are overdue by more than ninety days. The section "Statutory Accounting Developments" (page 11) gives additional information on the penalties for overdue reinsurance claims.

Assumed Reinsurance. Assumed reinsurance may be difficult to underwrite because the coverages are often unique. As such, some companies, particularly those that assume reinsurance only occasionally, may not have sufficient experience to manage such business or may not have adequate procedures to monitor the business. In addition, an assuming company may experience significant delays in receiving information from ceding companies, intermediaries, retrocessionaires, or other parties to the contracts, which may result in delays in notification of amounts of premiums written or losses incurred under the contracts, or a lack of supporting information needed for financial reporting and administration of the business.

Fronting. Fronting is the practice by which one insurance company (the fronting company) writes business with the agreement to cede all or nearly all of the risk to another insurance company (the fronted company). For example, fronting may be used in a geographical area in which the fronted company is not legally permitted to write business. Fronting arrangements may result in the fronting company having large potential liabilities to pay claims if the fronted company becomes unable or unwilling to meet its obligations. The fronting company may have little information about the nature and extent of the risks being

written under its policies on behalf of the fronted company. Consequently, the results of the fronting company may depend on the integrity and financial stability of the fronted company.

Investments

A company may attempt to increase its investment returns by investing in speculative or high-yield investments, such as "junk bonds" and real estate, which generally involve higher risk. These investments may be restricted for statutory purposes. Also, poor matching of investment maturities with cash flow needs may force an insurance company to liquidate its long-term investments at a loss to provide currently needed cash. Inadequate diversification of investments may result in volatile investment returns; a concentration of investments that are not readily marketable may indicate increased audit risk in the valuation of the investments. Additionally, real estate and mortgage loan investments may be experiencing difficulties because of depressed prices in certain real estate markets.

Management and Controls

An insurance company may delegate major operational authority to outside parties, such as to investment managers for investment decisions, managing general agents or third-party administrators for underwriting or claims functions, or claims settlement companies for claims management. In some instances, such outside parties have pursued objectives that conflict with those of the insurance company. If significant operational authority is delegated to outside parties, the company needs to establish sound procedures to supervise, control, and monitor the performance of those parties.

Regulatory, Accounting, and Reporting Developments

California Proposition 103 and Other Rate Regulation Efforts

Under the California initiative called Proposition 103 (as modified by a California Supreme Court decision), property and liability insurers are required to file with the California Insurance Department for approval to use existing premium rates or face automatic rollbacks of rates for policies issued or renewed after November 8, 1988. Furthermore, if the California Insurance Department finds that requested rates result in returns to insurers that are more than fair and reasonable, the insurers may be required to refund to policyholders the excess premiums received on policies issued or renewed after November 8, 1988.

In August 1989, the California Insurance Department made preliminary determinations that would require forty-seven insurance companies to make refunds totaling $815 million. Insurers have raised objections to the Insurance Department's methodology and calculations of the potential refunds, and the Department's findings will be challenged by insurers and various consumer representatives in public hearings and possibly in court actions. In November and December 1989 a rate freeze was in effect, which precludes insurers from raising rates until an agreement is reached on how to rate car insurance or on deferring the rating plan mandated by Proposition 103. (This freeze may be lifted prior to year end.)

Legislatures in several other states have adopted or are considering legislation that would limit or roll back certain premium rates. Also, in recent years, a number of states have adopted various forms of rate regulation for certain kinds of property and liability insurance or have denied or limited premium rate increases.

Evolving developments regarding Proposition 103 and similar regulations will require companies to monitor the possible effects of such developments on existing or new business and to evaluate the possible need for financial statement recognition or disclosure of those effects. Some companies may be unable to raise premiums, resulting in possible premium deficiencies.

Investment vs. Trading Securities

FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* states that "bonds shall be reported at amortized cost if the insurance enterprise has the ability and intent to hold the bonds until maturity and there is no decline in the market value of the bonds other than a temporary decline."

FASB Statement No. 60 also states that "if an insurance enterprise is a trader in bonds and does not intend to hold the bonds until maturity, bonds shall be reported at market and temporary changes in the market value of the bonds shall be recognized as unrealized gains or losses." There are similar provisions in the accounting literature for savings and loan institutions, banks, and other financial services entities.

In an April 1989 letter to the AICPA Accounting Standards Executive Committee (AcSEC), the chief accountant of the SEC stated the SEC's position that financial services entities should have a demonstrated ability and a positive intent to hold to maturity investments in debt securities that are carried at amortized cost, and that intent to hold to maturity should not be subject to conditions that are capable of being reasonably foreseen. The SEC asked the AICPA to develop guidance on this issue, and AcSEC expects to vote in January 1990 to expose for comment a proposed statement of position.

The SEC staff stated that they will be reviewing cash flow statements of registrants to detect companies in the financial services industries (including insurance companies) with significant sales activity in their investment portfolios. The SEC staff expects that Management's Discussion and Analysis in annual reports will discuss the reasons for trading activity in an investment portfolio and that discussions of realized gains in the portfolio should be accompanied by discussions of potential unrealized losses remaining in the portfolio.

Statutory Accounting Developments

Penalty for Overdue Reinsurance. Effective for 1989 statutory annual statements, property and liability insurers will be required to establish a reserve for reinsurance balances that are more than ninety days overdue. Such a reserve is to be equal to 20 percent of all recoverables and offsets from reinsurers for which more than 20 percent of their balances due on paid losses are more than ninety days overdue, plus 20 percent of all other recoverables on paid losses that are more than ninety days overdue. This penalty applies to authorized reinsurers; recoverables secured by funds held, letters of credit, or similar security are excluded from the calculation.

Accounting for Transfers Between Affiliates. The National Association of Insurance Commissioners' (NAIC) accounting manuals for life/health and property and liability insurance companies include new guidance on the accounting for transfers of assets between affiliates. The guidance provides criteria for distinguishing between *economic* and *noneconomic* transactions based on whether the transactions transfer the risks and rewards of ownership, have bona fide business purposes, and appear to be permanent.

In general, the guidance states that economic transfers of assets should be reported for statutory reporting purposes based on the fair market values of the assets at the dates of transfer. Noneconomic transfers between affiliated insurers should be reported at the lower of book value or market. Noneconomic transfers with a noninsurance affiliate should be reported at fair market value, but any gain to the insurer should be deferred until the permanence of the transfer has been demonstrated.

Securitization. Reporting of surplus generated from sales of future revenues has been prohibited by the NAIC, unless they comply with generally accepted accounting principles (GAAP) and are approved by the regulators.

SEC Developments

The SEC has issued a Staff Accounting Bulletin (SAB) that requires property and liability insurers to disclose reserve ranges in accordance with FASB Statement No. 5 for various situations, such as pollution claims. This SAB does not relate to normal year-end property and liability reserve for losses and loss-adjustment expenses.

* * * *

Copies of AICPA authoritative guidance may be obtained by calling the AICPA Order Department at (800) 334-6961 (USA) or (800) 248-0445 (NY). Copies of FASB authoritative guidance may be obtained directly from the FASB by calling the FASB Order Department at (203) 847-0700, ext. 10.

Audit Risk Alert—1989*

General Update on Economic, Industry, Regulatory, and Professional Developments

Introduction

This alert is intended to help you in planning your 1989 year-end audits. Successful audits are a result of a number of factors, including acceptance of clients with integrity, adequate partner involvement in planning and performing the audit, an appropriate level of professional skepticism, and allocating sufficient audit resources to high-risk areas. Addressing these factors in each audit engagement requires substantial professional judgment based, in part, on a knowledge of new professional standards and current developments in business and government.

This alert identifies areas that, based on current information and trends, may affect audit risk on many 1989 year-end audits. Although it isn't a complete list of risk factors to be considered, and the factors listed won't affect risk on every audit, you can use this alert as a planning tool for considering factors that may be especially significant for 1989 audits.

Expectation-Gap SASs

The Auditing Standards Board issued nine Statements on Auditing Standards (SASs)—Nos. 53-61—that are commonly called the expectation-gap SASs. Except for SAS No. 55 on internal control, all are effective for calendar-year 1989 audits (SAS No. 55 becomes effective next year); they all impose a number of new requirements. This summary highlights the new requirements that are expected to have the greatest effect on your audits. Remember though, this alert presents only highlights; there's a lot more material in the actual SASs that you'll need to consider in planning, performing, and reporting on your 1989 audits.

New Planning Requirements

Misstatements. SAS No. 53 restates the auditor's responsibility for detecting material misstatements. It requires the auditor to design the audit to provide *reasonable assurance of detecting errors and irregularities that are material* to the financial statements.

*This Audit Risk Alert was published in the December 1989 issue of the AICPA's *CPA Letter.*

Identifying Illegal Acts. SAS No. 54 changes the auditor's responsibility for detecting illegal acts. It says that the auditor's responsibility for detecting illegal acts that have a direct and material effect on the financial statements is the *same as for detecting material errors and irregularities* (see the item on SAS No. 53, above). The auditor's responsibility for identifying illegal acts with only an *indirect* effect on the financial statements differs: the auditor must be aware that such illegal acts may have occurred and follow up when they have been identified, but is not required to design the audit to detect these other illegal acts. (Certain types of illegal acts that may be of concern in 1989 audits are discussed later in this alert.)

Required Analytical Procedures. SAS No. 56 requires the application of analytical procedures in *planning* the audit. These procedures are intended to enhance the understanding of the client's business and activities and to identify areas of specific risk.

Auditing High-Risk Areas. The auditor should design the audit approach based on an assessment of risk. (See SAS No. 53.) The auditor should respond to increased risk of material misstatement by—

a. Assigning more experienced personnel to the engagement or increasing the level of supervision.

b. Changing the nature, timing, or extent of planned audit procedures.

c. Exercising a higher degree of professional skepticism.

New Performance Requirements

Heightened Professional Skepticism. SAS No. 53 says that the auditor should perform the audit with an attitude of professional skepticism—assuming *neither* management honesty nor dishonesty. This is an important change. The previous standard (SAS No. 16) assumed management integrity in the absence of evidence or circumstances to the contrary.

Required Analytical Procedures in Evaluation. SAS No. 56 requires that analytical procedures be applied at the *overall review* stage of the audit to assess the conclusions reached and the overall financial statement presentation.

Evaluating the Going-Concern Assumption. SAS No. 59 requires the auditor to evaluate in *every audit* whether there is a substantial doubt about the client's ability to continue as a going concern for one year beyond the balance sheet date. If, after considering information about management's plans for the future, a substantial doubt about the ability to continue remains, the auditor would add an explanatory paragraph to the audit report *regardless* of whether the assets and liabilities are appropriately valued or classified.

New Communication Requirements

New Auditor's Report. SAS No. 58 requires a new form of standard auditor's report.

Communication of Irregularities and Illegal Acts. SAS Nos. 53 and 54 require communication of all irregularities and illegal acts, except inconsequential ones, to the client's audit committee or, when the client doesn't have an audit committee, to persons with equivalent authority and responsibility, which, in a small business, may be the owner-manager.

Reporting Control Weaknesses. SAS No. 60 requires the auditor to report significant control weaknesses to the client, preferably in writing. SAS No. 60 sets a new benchmark for reporting on internal control: "*reportable condition*" replaces "material weakness."

Required Communications With Audit Committees. SAS No. 61 requires that certain matters be communicated whenever the client is a publicly held company *or* has an audit committee or oversight group, even if it's not public.

Applicability of SAS No. 63 on Compliance Auditing

Among other things, SAS No. 63 applies to reports on compliance with laws and regulations and internal control in engagements covered by government auditing standards (the GAO "Yellow Book"), but the *applicability is broader* than it might first appear. You may unexpectedly find yourself under government auditing standards and SAS No. 63.

Private Organizations

Due to federal laws, agency regulations, federal audit guides, and contractual agreements, the Yellow Book applies to *many private organizations*. For example, it might apply to the audit of a trade school because student financial aid is provided by the U.S. Department of Education, to a construction company because of financial guarantees provided by HUD, or to a financial institution because it processes government-guaranteed loans.

State Agencies

Some states have adopted the Yellow Book for all audits of their political subdivisions or agencies.

Illegal Acts

Certain types of illegal acts recently have caused audit concerns.

Environmental Issues

The reach of the federal Superfund legislation is greater than it might first appear. Under that law, anyone who ever owned or operated a hazardous waste site or generated or transported hazardous material to the site may be held responsible for cleaning it up. Thus, for example, a client that acquires through foreclosure property designated a hazardous waste site can be held responsible for the cleanup *even if it had nothing to do with creating the waste* or if the waste was present when the property was acquired.

Independent Contractors

The IRS has stepped up enforcement against abuses in classifying workers as independent contractors, rather than employees. Misclassification of workers as independent contractors may misstate the employer's liability for employment taxes and lead to *fines or penalties.*

Governmental Investigations

Recent governmental inquiries and investigations into some industries and practices (such as defense contractors or insider trading) may result in legal or regulatory challenges to customs or practices previously accepted in an industry.

Questionable Accounting and Fraudulent Financial Reporting

In recent years, the following situations have resulted in misstatements that auditors failed to detect. Consider whether they apply to your clients.

Revenue Recognition Issues

- Improper sales cutoffs
- Recording sales under bill-and-hold agreements, which cast doubt on whether a sale actually has taken place
- Recording as sales shipments to third parties "authorized" to accept goods on behalf of buyers
- Recording sales with written or oral rights of return when the chance of such return is not remote

- Treatment of operating leases as sales
- Nonrecording of sales returns
- Improper application of the percentage of completion method
- Undisclosed "side agreements" on sales, leases, etc.

Other Accounting Matters

- Improper deferral of costs
- Improper off-balance-sheet financing or transactions designed to disguise the substance of the transactions—especially when there are undisclosed "side agreements"
- Changing inventory count sheets

Red Flags of Possible Misstatements

- Unusually heavy sales volume near the end of the year
- Transactions that seem unnecessarily complex
- Aggressive growth of a company with a poor internal control structure
- Growth in sales or earnings shortly before an initial public offering

Highly Leveraged Companies (Including LBOs) and Holders of Junk Bonds

If you audit highly leveraged companies, such as those resulting from leveraged buyouts (LBOs), or clients that hold junk bonds, you may face these audit risks.

Highly Leveraged Companies

An economic slowdown in the client's industry or geographic area could strain the company's liquidity or cause loan covenant violations. In those cases, auditors need to consider: amounts and classification of liabilities; going-concern issues (the auditor's new responsibility for evaluating going concern was discussed earlier in this alert); and the entity's plans (such as asset dispositions or deferral of expenses) and their effects on operations, in light of expected economic conditions.

Holders of Junk Bonds

The market value of junk bonds may be affected by current events, such as extreme market fluctuations and new requirements for savings and loan institutions to dispose of their junk bonds. The value of the bonds may depend entirely on the creditworthiness of the issuer and the holder's ability to keep the bonds until maturity.

Loan Agreements

Current lending practices may affect classification of debt for clients that depend on credit provided by others.

Due-on-Demand Clauses

Some debt agreements have due-on-demand clauses even though future maturity dates are stated.

Subjective Acceleration

Some debt agreements have covenants that accelerate debt payments based on subjective criteria, such as "material adverse changes." Adverse developments in the financial-services industry or the economy may cause lenders to judge these criteria differently than in the past and seek to exercise their rights under these covenants.

Specialized Industries

While most of the items in this audit risk alert affect clients in many industries, there have been developments in specific industries that you may need to be aware of.

Financial Institutions

Recent congressional testimony and other developments indicated that risk may be increased in the following areas this year:

- Negative effects of local economies on real estate values and the resulting effects on the collateral underlying real estate loans and on collectibility of the loans
- Weak underwriting policies and procedures (particularly for home-equity loans) and their effect on ultimate collectibility
- Transactions that appear to lack economic substance
- Carrying value of securities

- Adequacy of allowances for credit losses on loans to less-developed countries (guidance is provided in the AICPA Auditing Procedure Study *Auditing the Allowance for Credit Losses of Banks*—product number 021050)

Pension Plans

A recent Department of Labor report disclosed findings that many independent auditors of employee benefit plans' financial statements failed to follow the AICPA guide *Audits of Employee Benefit Plans* and failed to properly disclose known violations of ERISA regulations. The report also noted that benefit plans' poor internal controls have led to understatements of employer contributions, improper disbursement of plan assets, and excessive administrative costs.

Current Environments in Specialized Industries

The AICPA has prepared four other updates that address the current environments in the savings and loan, credit union, property and liability insurance, and health care industries; each of these contains this audit risk alert as an appendix.

Savings and Loan Industry Developments—1989 (product number 022051), *Credit Union Industry Developments—1989* (022053), *Property and Liability Insurance Industry Developments—1989* (022054), and *Health Care Industry Developments—1989* (022052) are available from the AICPA order department at $2.50 each; $2.00 to members. Additional copies of this audit risk alert are also available in a separate booklet, *Audit Risk Alert—1989* (022050), at $2.00 each; $1.60 to members. Telephone orders can be placed by calling (800) 334-6961 (US), (800) 248-0445 (NY).

Recurring Audit Problems

Certain problems have been identified in more audits than others. Some areas where auditors may fall short are described below.

Attorney Letters

Attorneys' replies to requests for information about litigation claims, and assessments at times appear complete but in actuality contain vague or ambiguous language and are of little real use to the auditor. (An auditing interpretation of SAS No. 12 at AU 9337.18 in the AICPA *Professional Standards*, vol. 1, discusses what constitutes an acceptable reply and what to do when an unacceptable reply is received.) Also, replies may not be dated sufficiently close to the date of the audit report; additional inquiries may be needed.

Audit Programs

Written audit programs are required in all audits. They help your staff understand the work to be done and—together with other working papers—help you evaluate whether work has been performed adequately and whether the results of that work are consistent with the conclusions reached. It's important to be sure your audit programs are *adequately tailored* to reflect each *client's circumstances* and areas of greater *audit risk.*

*   *   *   *

Technical Hotline

The AICPA Technical Information Service answers AICPA members' inquiries about specific audit or accounting problems.

Call toll-free: (800) 223-4158 (Except New York)
(800) 522-5430 (New York Only)

022054