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American Institute of Certified Public Accountants. Insurance Companies Committee

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AICPA

American
Institute of
Certified
Public
Accountants

Statement of Position

94-1

Inquiries of State Insurance Regulators

April 20, 1994

**Amendment to
AICPA Audit and Accounting Guide
Audits of Property and Liability Insurance Companies
and AICPA Industry Audit Guide
*Audits of Stock Life Insurance Companies***

**Prepared by the
Insurance Companies Committee
Auditing Standards Division**

NOTE

This statement of position presents the recommendations of the AICPA Insurance Companies Committee regarding the application of generally accepted auditing standards to audits of financial statements of insurance enterprises. Members of the AICPA Auditing Standards Board have found the recommendations in this statement of position to be consistent with existing standards covered by rule 202 of the AICPA Code of Professional Conduct. AICPA members should be prepared to justify departures from the recommendations in this statement of position.

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SUMMARY

This statement of position (SOP) addresses the auditor's consideration of regulatory examinations as a source of evidential matter in conducting an audit on an insurance enterprise's financial statements and the auditor's evaluation of material permitted statutory accounting practices applied by insurance enterprises.

This SOP amends chapter 2, "Audit Considerations," of the AICPA Audit and Accounting Guide *Audits of Property and Liability Insurance Companies*, and chapter 9, "Auditing Procedures," of the AICPA Industry Audit Guide *Audits of Stock Life Insurance Companies*. It is effective for audits of financial statements for periods ending on or after December 15, 1994.

Inquiries of State Insurance Regulators

Introduction

1. This statement of position (SOP) addresses the auditor's consideration of regulatory examinations as a source of evidential matter in conducting an audit of an insurance enterprise's financial statements and the auditor's evaluation of material permitted statutory accounting practices.

Applicability

2. This SOP applies to audits of financial statements of life insurance enterprises,¹ property and casualty insurance enterprises, title insurance enterprises, mortgage guaranty insurance enterprises, assessment enterprises, fraternal benefit societies, reciprocal or interinsurance exchanges, pools other than public-entity risk pools, syndicates, and captive insurance companies. It amends chapter 2 ("Audit Considerations") of the AICPA Audit and Accounting Guide *Audits of Property and Liability Insurance Companies* and chapter 9 ("Auditing Procedures") of the AICPA Industry Audit Guide *Audits of Stock Life Insurance Companies*.²

Auditor's Consideration of State Regulatory Examinations

3. Statement on Auditing Standards (SAS) No. 57, *Auditing Accounting Estimates*, states that the auditor should consider evalu-

¹FASB Interpretation No. 40, *Applicability of Generally Accepted Accounting Principles to Mutual Life Insurance and Other Enterprises*, clarifies that FASB Statements and Interpretations and Accounting Principles Board (APB) Opinions apply to mutual life insurance enterprises, except when specifically exempted, that prepare financial statements in conformity with generally accepted accounting principles. This SOP applies to audits of mutual life insurance enterprises.

²The AICPA's Insurance Companies Committee technical agenda includes a project to supersede the Industry Audit Guide *Audits of Stock Life Insurance Companies*. The new Audit and Accounting Guide *Audits of Life and Health Insurance Enterprises* will include the guidance contained in this SOP.

ating “information contained in regulatory or examination reports, supervisory correspondence, and similar materials from applicable regulatory agencies.” SAS No. 54, *Illegal Acts by Clients*, notes that “the auditor may encounter specific information that may raise a question concerning possible illegal acts, such as . . . violations of laws or regulations cited in reports of examinations by regulatory agencies that have been made available to the auditor.” Accordingly, it is appropriate that the auditor review examination reports and related communications between regulators and the insurance enterprise to obtain competent evidential matter.

4. The auditor should review reports of examinations and communications between regulators and the insurance enterprise and make inquiries of the regulators. The auditor should—

- Request that management provide access to all reports of examinations and related correspondence including correspondence relating to financial conditions.
- Read reports of examinations and related correspondence between regulators and the insurance enterprise during the period under audit through the date of the auditor’s report.
- Inquire of management and communicate with the regulators, with the prior approval of the insurance enterprise, when the regulators’ examination of the enterprise is in process or a report on an examination has not been received by the insurance enterprise regarding conclusions reached during the examination.

5. A refusal by management to allow the auditor to review communications from, or to communicate with, the regulator would ordinarily be a limitation on the scope of the audit sufficient to preclude an unqualified opinion. (See SAS No. 58, *Reports on Audited Financial Statements* [AICPA, *Professional Standards*, vol. 1, AU sec. 508.40–.44].) A refusal by the regulator to communicate with the auditor may be a limitation on the scope of the audit sufficient to preclude an unqualified opinion, depending on the auditor’s assessment of other relevant facts and circumstances.

Auditor's Consideration of Permitted Statutory Accounting Practices

6. Prescribed statutory accounting practices currently include state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in a particular state; the National Association of Insurance Commissioners (NAIC) Annual Statement Instructions; the NAIC *Accounting Practices and Procedures Manuals*; the *Securities Valuation Manual* (published by the NAIC Securities Valuation Office); NAIC official proceedings; and the NAIC *Examiners' Handbook*.

7. Permitted accounting practices include practices not prescribed in paragraph 6 but allowed by the domiciliary state insurance department. Insurance enterprises may request permission from the domiciliary state insurance department to use a specific accounting practice in the preparation of their statutory financial statements (a) when the enterprise wishes to depart from the prescribed statutory accounting practices, or (b) when prescribed statutory accounting practices do not address the accounting for the transaction(s). Accordingly, permitted accounting practices differ from state to state, may differ from company to company within a state, and may change in the future.

8. Auditors should exercise care in concluding that an accounting treatment is *permitted*, and should consider the adequacy of disclosures in the financial statements regarding such matters.³ For each examination, auditors should obtain sufficient competent evidential matter to corroborate management's assertion that permitted statutory accounting practices that are material to an insurance enterprise's financial statements are permitted by the domiciliary state insurance department.

³The AICPA has issued an exposure draft of a statement of position, *Disclosures of Certain Matters in Financial Statements of Insurance Enterprises*, that would require insurance enterprises to disclose information about permitted statutory accounting practices in their financial statements prepared in conformity with generally accepted accounting principles.

9. Sufficient competent evidential matter consists of any one or combination of—

- Written acknowledgment sent directly from the regulator to the auditor. (This type of corroboration includes letters similar to attorneys' letters and responses to confirmations.)
- Written acknowledgment prepared by the regulator, but not sent directly to the auditor, such as a letter to the client.
- Direct oral communications between the regulator and the auditor, supported by written memorandum. (If the auditor, rather than the regulator, prepares the memorandum, the auditor should send such memorandum to the regulator to make sure it accurately reflects the communication.)

Auditors should use judgment to determine the type of corroboration that is necessary in the circumstances.

10. If the auditor is unable to obtain sufficient competent evidential matter to corroborate management's assertion regarding a permitted statutory accounting practice that is material to the financial statements, the auditor should qualify or disclaim an opinion on the statutory financial statements because of the limitation on the scope of the audit. (See SAS No. 58, *Reports on Audited Financial Statements* [AICPA, *Professional Standards*, vol. 1, AU sec. 508.40–.44].)

Effective Date

11. This SOP should be applied to audits of financial statements performed for periods ending on or after December 15, 1994.

Insurance Companies Committee
(1993–1994)

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