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Statement of Position

Confirmation of Insurance Policies in Force

Audits of Stock Life Insurance Companies

August 4, 1978

**Issued by the Auditing Standards Division
American Institute of Certified Public Accountants**

NOTICE TO READERS

The American Institute of Certified Public Accountants has issued a series of industry-oriented audit guides that present recommendations on auditing procedures and auditors' reports and in some instances on accounting principles, and a series of accounting guides that present recommendations on accounting principles. Based on experience in the application of those guides, AICPA committees may from time to time conclude that it is desirable to change a guide. A statement of position is used to revise or clarify certain of the recommendations in the guide to which it relates. A statement of position represents the considered judgment of the responsible AICPA committee.

To the extent that a statement of position is concerned with auditing procedures and auditors' reports, its degree of authority is the same as that of the audit guide to which it relates. As to those matters, members should be aware that they may be called on to justify departures from the recommendations of the committee.

To the extent that a statement of position relates to standards of financial accounting or reporting (accounting principles), the recommendations of the committee are subject to ultimate disposition by the Financial Accounting Standards Board. The recommendations are made for the purpose of urging the FASB to promulgate standards that the committee believes would be in the public interest.

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Confirmation of Insurance Policies in Force

1. In February 1975, the AICPA Special Committee on Equity Funding stated “. . . except for certain observations relating to confirmation of insurance in force and auditing related party transactions, generally accepted auditing standards are adequate and . . . no changes are called for in the procedures commonly used by auditors.” The AICPA industry audit guide, *Audits of Stock Life Insurance Companies* (page 32), states: “It may also be appropriate to select in-force policies for confirmation directly with policyholders of premium amounts, date to which premiums are paid, policy loans, accumulated dividends, etc.” The special committee recommended “that the Institute’s auditing standards executive committee consider whether the Life Insurance Audit Guide requires clarification with regard to the confirmation of policies with policyholders.”

2. The special committee further stated:

Another auditing procedure, which heretofore has not been considered particularly useful, is verification of the authenticity of a selected number of policies included in the in-force inventory by direct confirmation with the policyholders. Such a procedure has not generally been considered necessary because it would be unusual for companies to overstate liabilities. Inflation of the inventory of life insurance in force by a company that follows statutory accounting would result in an overstatement of the liability for future policyholder benefits and a reduction in current earnings. However, when companies report on the basis of generally accepted accounting principles (GAAP) there could be motivation for overstating insurance in force because it could result in an addition to current earnings.

There could be an additional motivation for overstating insurance in force when reinsurance of policies has the effect of materially increasing current earnings, which can occur when a company reports on the basis of either GAAP or statutory accounting. Reinsurance of life insurance policies permits the elimination of the related liability for future policyholder benefits. Under cer-

tain circumstances, reinsurance may also result in increasing current earnings to the extent that the proceeds received from reinsurance exceed expenses incurred in connection with the sale and servicing of the reinsured policies.

3. As stated above, the audit guide suggests confirmation of insurance policies in force directly with policyholders; however, the audit guide does not discuss circumstances when confirmation would be appropriate and, as a result, practice has varied. The purpose of this statement of position is to identify those circumstances in which the independent auditor ordinarily should confirm insurance policies in force. This statement of position is applicable to both stock and mutual life insurance companies.

4. Satisfactory results of the comparison of insurance policies in force with premium collections along with other ordinary auditing procedures (see pages 31-34, 46-47, and 96 of the audit guide) will normally provide the auditor with sufficient competent evidential matter as to the validity of those policies included in the inventory of insurance policies in force. However, the auditor ordinarily should confirm insurance policies in force with policyholders in the following circumstances:

- a.* Proper maintenance of the inventory of insurance in force may be materially deficient due to an absence of segregation of duties or other controls.
- b.* Trend analyses or ratios that measure insurance in force indicate erratic or unusual results that have not been satisfactorily explained.
- c.* Additions to insurance in force cannot be related to the collection of premiums.
- d.* Significant amounts of insurance in force result from related party transactions, and the related party's financial statements are not examined by the auditor.
- e.* The company markets insurance products, such as those with immediate cash value features or with unusual commissions arrangements, that could motivate the agent to submit fictitious policies.
- f.* Ceded reinsurance activities can materially increase earnings or investable funds.

Effective Date

5. This statement of position provides for practices that may differ in certain respects from present acceptable practices. Accordingly, this statement of position will be effective for examinations made in accordance with generally accepted auditing standards for periods ending on or after December 31, 1978.