2009 Insurance Industry Developments

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Insurance Industry Developments – 2009

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
2009

Insurance Industry Developments

Strengthening Audit Integrity
Safeguarding Financial Reporting
Notice to Readers

This Audit Risk Alert is intended to provide auditors of financial statements of insurance entities with an overview of recent economic, industry, technical, regulatory, and professional developments that may affect the audits and other engagements they perform. This Audit Risk Alert also can be used by an entity’s internal management to address areas of audit concern.

This publication is an other auditing publication, as defined in AU section 150, Generally Accepted Auditing Standards (AICPA, Professional Standards, vol. 1). Other auditing publications have no authoritative status; however, they may help the auditor understand and apply the Statements on Auditing Standards.

If an auditor applies the auditing guidance included in an other auditing publication, he or she should be satisfied that, in his or her judgment, it is both relevant to the circumstances of the audit and appropriate. The auditing guidance in this document has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

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How This Alert Helps You

.01 This Audit Risk Alert (alert) helps you plan and perform your insurance audits and also can be used by an entity’s internal management to address areas of audit concern. This alert provides information to assist you in achieving a more robust understanding of the business, economic, and regulatory environments in which your clients operate. This alert is an important tool to help you identify the significant risks that may result in the material misstatement of financial statements and delivers information about emerging practice issues and current accounting, auditing, and regulatory developments. You should refer to the full text of accounting and auditing pronouncements as well as the full text of any rules or publications that are discussed in this alert.

.02 Certain accounting guidance referenced in this alert has been codified into the Financial Accounting Standards Board (FASB) Accounting Standards Codification™ (ASC). On June 30, 2009, FASB issued FASB Statement No. 168, The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162. On the effective date of this statement, FASB ASC became the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the Securities and Exchange Commission (SEC). At that time, FASB ASC superseded all then-existing, non-SEC accounting and reporting standards for nongovernmental entities. Once effective, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. See the discussion of FASB ASC in the “Accounting Issues and Developments” section of this alert.

Audit Risk

.03 It is essential that the auditor understand the meaning of audit risk and the interaction of audit risk with the objective of obtaining sufficient appropriate audit evidence. In AU section 312, Audit Risk and Materiality in Conducting an Audit (AICPA, Professional Standards, vol. 1), audit risk is broadly defined as the risk that the auditor may unknowingly fail to appropriately modify his or her opinion on financial statements that are materially misstated. At the account balance, class of transactions, relevant assertion, or disclosure level, audit risk consists of the risks (both inherent risk and control risk) that the relevant assertions related to balances, classes, or disclosures contain misstatements (whether caused by error or fraud) that could be material to the financial statements when aggregated with misstatements in other relevant assertions related to balances, classes, or disclosures and the risk (detection risk) that the auditor will not detect such misstatements.

.04 The auditor’s combined assessment of inherent risk and control risk is described as the risks of material misstatement. The auditor should use information gathered by performing risk assessment procedures, including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented, as audit evidence to support the risk assessment. The auditor should use the risk assessment to determine the nature, timing, and extent of further audit procedures to be performed.

.05 As set forth in paragraph .12 of AU section 312, the auditor may reduce audit risk by determining overall responses and designing the nature, timing, and extent of further audit procedures. Furthermore, paragraph .19 of AU section 312 explains that the auditor should seek to reduce audit risk at
the individual balance, class, or disclosure level in such a way that will enable the auditor to express an opinion on the financial statements as a whole at an appropriately low level of audit risk.

**Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement**

.06 AU section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1), establishes requirements and provides guidance about implementing the second standard of field work, as follows: "The auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures." Obtaining this understanding is further complicated by the rapidly changing economic environment. In accordance with paragraph .04 of AU section 314, the auditor's primary consideration is whether the understanding that has been obtained is sufficient to assess risks of material misstatement of the financial statements and to design and perform further audit procedures.

.07 The auditor's understanding of the entity and its environment consists of an understanding of the following:

- Industry, regulatory, and other external factors
- Nature of the entity
- Objectives and strategies and the related business risks that may result in a material misstatement of the financial statements
- Measurement and review of the entity's financial performance
- Internal control, which includes the selection and application of accounting policies

.08 Appendix A of AU section 314 contains examples of matters that the auditor may consider in obtaining an understanding of the entity and its environment relating to the categories previously discussed. Understanding the effects of the current economic climate on each specific audit client is a key step in designing the audit plan.

.09 Business risks result from conditions, events, circumstances, actions, or inactions that could adversely affect the entity's ability to achieve its objectives and execute its strategies. The setting of inappropriate objectives and strategies also results in business risks. Just as the external environment changes, the handling of the entity's business also is dynamic, and the entity's strategies and objectives change over time. An understanding of business risks increases the likelihood of identifying risks of material misstatement; however, the auditor does not have a responsibility to identify or assess all business risks. Most business risks will eventually have financial consequences and, therefore, an effect on the financial statements; however, not all business risks give rise to risks of material misstatement.

.10 Additionally, insurance entities may be subject to specific risks of material misstatement arising from the nature of the business, the degree of regulation, or other external forces (for example, political, economic, social, technical, and competitive forces). After obtaining a sufficient understanding of the entity
and its environment, including its internal control, an auditor should identify and assess the risks of material misstatement at the financial statement level and at the relevant assertion level related to classes of transactions, account balances, and disclosures based on that understanding. Understanding and properly addressing, as necessary, the matters presented in this alert will help you gain a better understanding of your client’s environment, better assess risks of material misstatement of the financial statements, and strengthen the integrity of your audits.

Economic and Industry Developments

The Current Economic Crisis

.11 When planning and performing audit engagements, an auditor should understand the economic conditions facing the industry in which the client operates. Economic activities relating to factors such as interest rates, availability of credit, consumer confidence, overall economic expansion or contraction, inflation, and labor market conditions are likely to have an effect on an entity’s financial statements.

.12 Currently, the U.S. economy continues to experience severe instability. The National Bureau of Economic Research officially declared that, as of December 2007, the United States slid into a recession. The length and severity of the economic downturn are yet to be determined. Some key occurrences that exhibit the gravity of the economic crisis include the following:

- U.S. real gross domestic product (GDP), the broadest measure of economic activity, continues to decrease.
- The number of jobless claims remains high.
- The Federal Reserve has maintained the federal funds interest rate at a historically low level.
- Federal government intervention in the private sector has increased. Numerous financial institutions and automakers have received bailouts from the government.
- Millions of households owe more on their mortgages than their homes are currently worth. The number of residential home foreclosures continues to increase.
- The financial markets continue to experience instability—historic lows followed by rallies. In March 2009, the S&P 500 and Dow Jones Industrial Average reached their 12-year lows, and NASDAQ closed at its lowest point since October 2002.
- The demand for U.S. Treasury bills has increased at a staggering rate, which drove the interest rate for these Treasury bills to less than 1 percent in March 2009.
- The Treasuries-Over-Euro-Dollar Spread reached 4.63 percent in October 2008, a historic high, before returning to 1.04 percent in March 2009.

Key Economic Indicators

.13 These key economic indicators further illustrate the severity of the recessionary period the United States is experiencing.
The GDP measures output of goods and services by labor and property within the United States. It increases as the economy grows or decreases as it slows. According to an estimate from the Bureau of Economic Analysis, real GDP decreased at an annual rate of 0.7 percent in the second quarter of 2009. This data indicates a moderation in the slowing of the economy seen in the fourth quarter of 2008 and first quarter of 2009, which experienced decreases of 6.3 and 5.5 percent, respectively.

The unemployment rate began to level out from June, through September 2009. During that period it remained between 9.4 percent and 9.8 percent. An unemployment rate of 9.8 percent represents approximately 15.1 million people. Since the start of the recession in December 2007, the number of unemployed persons has increased by as much as 7.6 million or 4.9 percentage points.

As of March 2009, the Federal Reserve had decreased the target for the federal funds rate more than 5.0 percentage points to less than 0.25 percent. The Federal Reserve noted in its September 23, 2009, press release “that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period.”

Government Intervention to Curtail the Economic Crisis

The U.S. government has taken unprecedented actions to prevent worsening economic conditions, including passing the American Recovery and Reinvestment Act of 2009 (Recovery Act) and the Emergency Economic Stabilization Act of 2008 (EESA), facilitating the sale of ailing banks and dramatically increasing the monetary programs available from the Federal Reserve. The results of these actions have not been fully realized to date.

The American Recovery and Reinvestment Act of 2009

In February 2009, President Obama signed legislation designed to work hand in hand with the EESA to stimulate the U.S. economy. The Recovery Act is designed primarily to combat the rising unemployment trends, put more money in the hands of consumers, and reduce the likelihood that state and local governments will need to raise taxes significantly. According to the White House press release, the legislation will do the following:

- Create or save 3.5 million jobs in the next 2 years
- Provide direct tax relief to working and middle class families
- Double the U.S. renewable energy generating capacity over 3 years
- Stimulate private investment in renewable energy through tax credits and loan guarantees
- Invest $150 billion in U.S. infrastructure projects
- Provide funds to U.S. state and local governments to support health and education programs

Many of the provisions of this legislation took effect immediately in an effort to stimulate consumer spending and boost the economy. The total cost of the spending in the Recovery Act is $787 billion, which is in addition to the $700 billion in the EESA. Many economists are concerned that further financial support may be necessary before an economic recovery is possible. Additionally, the federal government developed the Web site www.recovery.gov to
facilitate a transparent process to ensure accountability for the execution of the package.

Other Government Intervention

The passage of the Recovery Act came shortly after the passage of the EESA, which was signed into law in October 2008. As stated in Section 2 of the EESA bill, it “provide[s] authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States” to ensure the economic well-being of Americans. Primary components of the EESA bill include the following:

- An allocation of $700 billion to stabilize the U.S. financial system
- The creation of an oversight board, executive compensation rules, and other corporate governance rules for any entities that receive government aid
- An increase of the statutory limit on public debt from $10.0 trillion to $11.3 trillion
- A temporary increase of Federal Deposit Insurance Corporation insurance limits
- The creation of a tax modification for Fannie Mae and Freddie Mac stock losses
- The restatement of the SEC’s authority to suspend the application of FASB Statement No. 157, *Fair Value Measurements*, which is codified in FASB ASC 820, *Fair Value Measurements and Disclosures*
- The requirement of the SEC to conduct a study on the impact of FASB’s fair value guidance

The EESA authorized the U.S. Treasury to create the Troubled Assets Relief Program (TARP), the original intent of which was to use $700 billion to purchase illiquid mortgage assets from banks. As part of TARP, the Capital Purchase Program (CPP) was intended to inject $250 billion of capital into banks. Half of the CPP funds were distributed to 9 of the largest financial institutions in the nation, which held approximately 55 percent of U.S. banking assets. The other half of the funds were allocated for smaller financial institutions. The clear intent of the CPP was for the participating banks to increase lending; however, many question if the banks have responded accordingly.

The U.S. Treasury expanded TARP to provide up to $22 billion in bailout funds for several struggling life insurance entities. Several eligible life insurers accepted TARP funds and were able to raise adequate capital and improve their S&P ratings from “negative” to “stable.” Other life insurers had acquired regulated savings and loans institutions in order to become eligible for TARP but later declined participation in the program. These entities have either claimed to have strong capital positions and financial health or are considering other options for raising capital including common stock offerings.

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23 In addition to bailout funds targeting financial institutions, a $17.4 billion rescue package for the U.S. automakers was issued in December 2008. The first $13.4 billion was lent to the automakers immediately, and the remaining $4 billion was lent in subsequent months. The U.S. government will continue to work directly with automakers and also will receive nonvoting warrants from automakers that accept taxpayer funding.

24 The complete effects of the Recovery Act, as well as the other government interventions, will take time to be felt throughout the economy; however, the primary goal is to increase market confidence and liquidity.

Industry Trends and Conditions

Life and Health Insurance Industry

Impact of the Financial Crisis on the Life Insurance Industry

25 Throughout 2009, the life insurance industry has been affected adversely by the global economic downturn and turbulent financial markets. Most life insurance entities experienced net losses in 2008 and the first quarter of 2009. According to A.M. Best’s June 22, 2009, special report, Life Annuity Companies Adjust to Volatile Markets, individual life sales generally are not affected by recessions but have declined more than 25 percent for the industry due to the severity of this economic downturn. Significant capital losses have been attributed to inadequate pricing, the volume of claims and expenses exceeding expectations, and investment declines particularly related to portfolios with structured or commercial mortgage-related products. There have been several downgrades by rating agencies due to poor earnings and inadequate capital. This decline in capital has caused some entities to become concerned with meeting regulatory requirements related to statutory surplus in order to avoid regulator intervention.

26 As discussed by the National Association of Insurance Commissioners’ (NAIC’s) report, Life Insurer Solvency, despite the recessionary effects experienced by the life insurance industry, insurance regulators maintain that the majority of life insurance entities are capitalized adequately, and the industry is positioned for future success. According to the NAIC’s report, Life Insurer Solvency, and A.M. Best’s June 22, 2009, special report, Life Annuity Companies Adjust to Volatile Markets, long-term trends look favorable for the industry as a result of the following factors:

- Life insurance entities generally invest for the long-term.
- Credit spreads have narrowed significantly, indicating possible recovery of the financial markets.
- Portfolio investment yields have remained reasonably steady.
- Access to the capital markets has normalized.
- The recent rally in equity markets and opening of credit markets.

Outlook for Health Insurance Entities

27 Health insurance entities have been faced with numerous challenges during 2009. The industry remains highly competitive, and the opportunity for growth is limited. According to A.M. Best’s February 6, 2009, research report, Recession, Reform and Competition Will Pressure Health Insurers’ Results, the
potential for declining enrollment seems imminent given the current recessionary economic environment. Investment income also has declined significantly due to lower interest rates and deteriorating financial markets.

As discussed in A.M. Best’s May 4, 2009, special report, Multiple Issues Adversely Impact Health Care Results for 2008, the recession has, and will likely continue, to significantly affect health insurance entities. Employers and individuals are expected to request lower premiums and negotiate lower rate increases. Layoffs, companies closing, and smaller employers dropping insurance coverage will lead to enrollment declines. Individuals who are unemployed also are not likely to enroll in individual policies as a result of the high cost. Also, according to A.M. Best’s February 6, 2009, research report, Recession, Reform and Competition Will Pressure Health Insurers’ Results, although the health insurance industry likely will experience pressure on earnings due to the recession, health insurance entities are expected to be able to withstand this downturn. Health insurers have built up capital levels over the past few years and should be able to control administrative expenses to offset the decline in enrollment.

**Property and Casualty Insurance Industry**

According to A.M. Best’s 2009 special report, U.S. Property/Casualty—3-Month Financial Review, U.S. property and casualty insurance net income plunged approximately 87 percent to $1.2 billion in the first quarter of 2009. Net premium written (NPW) fell $4.2 billion or 3.7 percent, to $107.6 billion from $111.8 billion. The industry recorded an underwriting loss of $0.8 billion, as the combined ratio rose to 100.5 from 99.8.

According to SNL Financial, the premium trend continued in the second quarter, with industry NPW declining further to $104 billion in the second quarter of 2009, compared to $108 billion in the second quarter of 2008. Similar patterns can be observed for direct premiums written and earned premiums. According to A.M. Best’s 2009 special report: U.S. Property/Casualty: 6-Month Financial Review. U.S. Property/Casualty Industry Results Mixed in First-Half 2009, statutory underwriting performance improved, however, with the industry posting a $1.4 billion gain, affected positively by improved results from financial insurers. Evidence also indicates that the industry has been engaged in systematic reserve releases, which are helping to drive the improvements.

Industry performance has been driven primarily by the market conditions for pricing and the related reserve releases, housing and credit crisis faced by mortgage insurers and financial guarantee insurers, catastrophe losses, and a volatile investment market. Each of these performance factors are discussed subsequently in more detail.

**Pricing Trends**

According to Towers Perrin’s Commercial Lines Insurance Pricing Survey, commercial insurance prices dropped less than 1 percent during the first quarter of 2009. This is the smallest price decrease reported in four years, which leads Towers Perrin to suggest the soft market is flattening out.

P&C National Underwriter made the observation that property and casualty insurance entities may be forced to raise prices soon because increased harvesting of reserve redundancies is expected to leave a limited cushion for 2009, according to a recent Moody’s report, "U.S. P&C Insurers Reap large Reserve Redundancy."
According to the P&C National Underwriter, Moody's said that during 2008, the property and casualty insurance industry posted nearly $14.3 billion in favorable reserve development, or about 2.8 percent of prior year-end carried reserves, representing the fourth straight year of favorable reserve releases for the industry.

Impact of the Housing and Credit Crisis on Mortgage and Financial Guarantee Insurers

Since 2007, securities backed by subprime mortgages have gone into default at record rates due to the slump in the housing market and loans that were extended to borrowers with poor credit histories. Mortgage insurers now face substantial borrower defaults on loans that were approved when the process of securing a mortgage was less difficult. During 2008, many mortgage and financial guarantee insurers reported significant underwriting losses.

Delinquencies and foreclosures set record highs in the second quarter of 2009. According to data released on August 20, 2009, by the Mortgage Bankers Association, 4 percent of all U.S. homeowners are in default as of June 30, 2009, and more than 9 percent have missed at least one payment on their mortgage. The situation is likely to worsen as unemployment reaches new highs because a significant percentage of homeowners owe more than their homes are worth.

According to A.M. Best's 2009 special report, U.S. Property/Casualty—3-Month Financial Review, as of July 13, 2009, although these lines only account for a small percentage of the industry's net premiums written, their loss impact caused a two percentage point deterioration on the industry-wide combined ratio as compared with less than one percentage point historically. As a result, major rating agencies have downgraded the financial strength ratings of several mortgage insurance entities. Additionally, stock prices for these insurers are decreasing. In reaction, mortgage insurers have continued to tighten their standards, making such insurance more challenging to obtain.

Continuation of the Soft Market Conditions

For the fifth consecutive year, the property and casualty insurance market remains soft as a consequence of a sustained, highly aggressive pricing environment, as well as a significant reduction in demand for insurance driven by a deepening global recession. The commercial lines are being more affected due to the reduction in employment (employee count) and the reduction of construction and manufacturing activity.

Weather and Catastrophes

According to A.M. Best's special report, U.S. Property/Casualty—3-Month Review, insured catastrophe losses reached $3 billion in the first three months of 2009, down from $3.4 billion reported during the same period in 2008. Catastrophic losses have remained low during the second quarter of 2009. Munich Re Group reported in July that natural disasters cost insurance entities

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4 Subprime mortgages are mortgages used by borrowers with low credit ratings, who are considered risky by lending agencies because the default risk is greater than that of other borrowers. Due to this, lenders charge a higher interest rate on subprime loans.
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$11 billion in the first half of 2009. Economic losses were estimated to be $25 billion worldwide, compared to an average of $42 billion over the past 10 years. However, because several disasters have occurred in high insurance density locations in the United States and Europe, there has been a relatively high ratio of insured to economic losses. According to the July 27, 2009, press release of Munich Re NatCat SERVICE, in the United States, there were substantial losses with windstorms and hail events in the first two quarters of 2009, totaling $5.9 billion in insured losses for the four largest events. Despite the relatively quiet start to the year related to hurricane activity, the National Oceanic and Atmospheric Administration has forecasted the 2009 hurricane season to be near normal, with a 70 percent chance of having between 9 and 14 named storms.

Volatile Investment Market

The property and casualty insurance industry’s profitability has been further adversely affected by the continuing volatile investment markets. Stock prices declined significantly in 2008, credit spreads widened on fixed income securities, and the Federal Reserve consistently cut federal fund rates down to historic lows. Approximately two-thirds of the investments of property and casualty insurance entities are in bonds, which are sensitive to interest rates.

In early March of 2009, equity markets reached low levels not seen since 1996. Markets subsequently have begun to stabilize and recover and show a modest gain of 3.1 percent as of June 30, 2009. Markets continue to face significant challenges moving into the second half of 2009, as the economy begins to recover.

Legislative and Regulatory Developments

Recent Statutory Accounting Principles

The NAIC continues to develop and clarify statutory accounting guidance for insurance enterprises through its ongoing maintenance process. The most recent Accounting Practices and Procedures Manual (manual) was published by the NAIC as of March 2009 and contains accounting practices and procedures adopted by the NAIC through March 2009. Updates to the manual can be found under the Statutory Accounting Principles Working Group section of the NAIC Web site. Insurance laws and regulations of the state insurance departments require insurance entities domiciled in those states to comply with the guidance provided in the manual, except as otherwise prescribed or permitted by state law or regulation.

The 2009 manual contains two new Statements of Statutory Accounting Principle (SSAPs) that were adopted through March 2009:

- SSAP No. 98, Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an Amendment to SSAP No. 43—Loan-backed and Structured Securities. SSAP No. 98 was adopted in April 2009, and was effective for periods ending September 30, 2009. In September 2009, the NAIC adopted SSAP No. 43—Revised, (SSAP No. 43R) Loan-backed and Structured Securities,


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that supersedes SSAP No. 98 (before its effective date) and paragraph 13 of SSAP No. 99.

- SSAP No. 99, Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment. SSAP No. 99 was adopted in September 2008 and was effective for reporting periods beginning on or after January 1, 2009. The guidance in SSAP No. 43R, supersedes paragraph 13 of SSAP No. 99.

SSAP No. 43R modifies statutory accounting principles for investments in loan-backed and structured securities. The guidance specifies that if the insurer determines there has been an other-than-temporary impairment and either intends to sell the loan-backed or structured security, or does not have the intent and ability to retain the investment for the time sufficient to recover the amortized cost, then the security is written down to fair value. If the insurer does not expect to recover the entire amortized cost basis of the security when it does not intend to sell the security, and it has the intent and ability to hold the security, the amount of the other-than-temporary impairment recognized as a realized loss shall equal the difference between the investment’s amortized cost basis and the present value of cash flows expected to be collected and discounted at the effective interest rate in accordance with paragraph 32 of SSAP No. 43R.

SSAP No. 43R specifies transition guidance for insurers that accounted for loan-backed and structured securities under SSAP No. 43; SSAP No. 98 through early adoption; or had an accounting policy in accordance with the prescriptions of SSAP No. 98.

SSAP No. 99 adopts paragraph 16 of FASB Staff Position (FSP) FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, which provides that upon impairment of a debt security, the discount or premium is amortized over the remaining life of the security prospectively. SSAP No. 99 provides clarification to the impairment guidance in SSAP No. 26, Bond Categories, SSAP No. 32, Investments in Preferred Stock (including investments in preferred stock of subsidiary, controlled, or affiliated entities), SSAP No. 34, Employee Benefits, and SSAP No. 43.

Ten new interpretations were adopted during 2008 and incorporated into the March 2009 manual. Also, several nonsubstantive revisions to various SSAPs and manual appendices were made during 2008 by the NAIC. Interpretations are immediately effective upon adoption by the NAIC, and new SSAPs occasionally are effective for the calendar year they are adopted.

Actuarial Guideline XLIII (AG 43), CARVM for Variable Annuities, also known as VA CARVM (Variable Annuity Commissioners Annuity Reserve Valuation Model), is a new statutory reserve standard for variable annuity products with guaranteed death and living benefits and is effective as of December 31, 2009. The scope of AG 43 includes all individual and group, deferred, and immediate variable annuities. The reserve calculation includes a standard scenario floor and likely will result in higher statutory reserves than under the current requirements.

The NAIC’s Sarbanes-Oxley Initiative Update

The NAIC adopted changes to the Annual Financial Reporting Model Regulation (Model Audit Rule) related to the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) during its fall 2006 meeting, with the majority of the changes
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Effective for 2010. Through August 2009, 31 states have adopted the revised Model Audit Rule. Of the remaining states and regions, 19 intend to adopt or present revisions to the Model Audit Rule to their respective legislatures during 2009, and 1 state plans to have adoption completed within the first half of 2010. To date, no states have reported any significant issues when they adopted revisions to the revised Model Audit Rule.

Highlights of the significant changes to the current Model Audit Rule related to Sarbanes-Oxley include the following:

- **Section 7:** The time allowed to serve in the capacity as the lead or coordinating audit partner was decreased from seven years to five consecutive years with a new five year break in service (previously two years), effective beginning with year 2010 statutory audits.

- **Section 7:** A list of nonaudit services that cannot be performed by the auditor (the prohibitions generally agree with those designated by the SEC), effective for the year 2010 statutory audits. Insurance entities with less than $100 million in direct written and assumed premium may request an exemption from this requirement.

- **Section 9:** To the extent required by AU section 319, Consideration of Internal Control in a Financial Statement Audit (AICPA, PCAOB Standards and Related Rules, Interim Standards), for those insurers required to file a management’s report on internal control over financial reporting pursuant to Section 16 (see the following “Section 16” bullet point), the independent CPA should consider the most recently available report in planning and performing the audit of statutory financial statements.

- **Section 11:** Auditors should prepare a written communication of any unremediated material weaknesses that the insurer will furnish the domiciliary commissioner, effective beginning with year 2010 statutory audits. The current Model Audit Rule requires the auditor to prepare a report of significant deficiencies and material weaknesses in the insurer’s internal control structure noted by the auditor during the audit.

For several years, the AICPA NAIC Task Force has undertaken efforts to confirm that states will accept the reporting of only those significant deficiencies and material weaknesses that are unremediated as of the balance sheet date, and it will continue to do so until the year 2010 effective date of the revised Model Audit Rule.

- **Section 14:** New specifications for the responsibilities of audit committees and the required qualifications of audit committee members will be effective January 1, 2010. The adopted revisions require that insurance entities have an audit committee that is solely responsible for the appointment, compensation, and oversight of the entity’s auditor. The guidance also indicates that some audit committees, based on the insurer’s premium volume, would need to comprise a certain percentage of individuals who are independent from management. The premium threshold that triggers the requirement for independent audit committee members is $300 million assumed, and direct premiums. The premium range for a majority (50 percent or more) of independent audit committee members is $500 million assumed, and direct premiums.
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members is from $300 million to $500 million. The requirement for a supermajority (75 percent or more) of independent audit committee members is $500 million in premiums. Notwithstanding premium volume, all insurers are encouraged to structure their audit committees with at least a supermajority of independent audit committee members.

Entities meeting certain requirements may request an exemption from its domiciliary commissioner based on hardship. Examples include requests based on the business type of the entity, the availability of qualified board members, or the ownership or organizational structure of the entity.

- **Section 16:** Every insurer required to file an audited financial report that has an annual direct written and assumed premium of $500 million or more shall prepare a report of the insurer's or group of insurers' internal control over financial reporting and file it with their insurance commissioner, effective December 31, 2010. The Model Audit Rule also includes a list of what should be included in management's report on internal control over financial reporting. This report is prepared by management and is not audited.

An insurer that is a Sarbanes-Oxley compliant entity or is a direct or indirect wholly owned subsidiary of a Sarbanes-Oxley compliant entity will be able to file its or its parent's Sarbanes-Oxley Act Section 404 report in satisfaction of this Section 16 requirement. However, there also is an addendum that needs to be filed with the Sarbanes-Oxley Act Section 404 report that would include a positive statement that no material processes exist related to the preparation of the audited statutory financial statements that were excluded from the Sarbanes-Oxley Act Section 404 report. If internal controls exist that have a material impact on the preparation of the audited statutory financial statements, they need to be addressed. The insurer may either file a report under Section 16, or the insurer can file its Sarbanes-Oxley Act Section 404 report and a Section 16 report for those internal controls that would have a material impact on the audited statutory financial statements and were not covered by the Sarbanes-Oxley Act Section 404 report.

The independent CPA should consider this report during the planning and performance of the annual audit. In addition, the proposed revisions require the insurer to file with the state insurance department the independent public accountant's communication regarding any unremediated material weaknesses noted during the course of the audit.

- **Section 17:** An insurer may make written application to the commissioner for waiver from any or all provisions of the model based upon financial or organizational hardship. For example, the commissioner could, under this section, grant a waiver of the Section 14B audit committee independence requirements to an entity exceeding the $500 million premium threshold, even though the Section 14H waiver would not apply. This exemption is granted at the
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discretion of the commissioner and may be granted at any time for a specified period or periods.

SSAP No. 9 Considerations

.51 SSAP No. 9, Subsequent Events, which is based on AU section 560, Subsequent Events (AICPA, Professional Standards, vol. 1), defines subsequent events and establishes criteria for recording such events in the financial statements or disclosing them in the notes to the financial statements. All information that becomes available prior to the issuance of the financial statements relating to a material type I subsequent event (currently defined in SSAP No. 9 as "events that provide additional evidence with respect to conditions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements") should be used by management in determining the related accounting estimate.

.52 During 2007, the NAIC Statutory Accounting Principles (SAP) Working Group adopted revisions to paragraph 13 of SSAP No. 55, Unpaid Claims, Losses and Loss Adjustment Expenses, to address the issue of whether accounting judgments and estimates inherent in the preparation of statutory-basis financial statements should be updated to reflect type I subsequent events occurring between the annual statement filing date and the issuance of the audited statutory-basis financial statements. This amended paragraph clarifies that liabilities for unpaid claims, losses, and loss adjustment expenses within the scope of SSAP No. 55 are not expected to be restated. Rather, additional information that is obtained after the submission of the annual statement that is not indicative of an error in the estimation process is considered part of the continuous review process and should be reflected in the statement of operations in the period the change becomes known.

.53 Readers should be aware that this guidance applies only to unpaid claims, losses, and loss adjustment expenses within the scope of SSAP No. 55, and that to be compliant with SSAP No. 9 as currently written, entities will need to have a process in place to update other judgments and estimates for type I subsequent events occurring between the annual statement filing date and the issuance of the audited statutory-basis financial statements.

.54 FASB ASC 855, Subsequent Events, which reflects the principles underpinning current subsequent events guidance in existing accounting literature and in AU section 560, provides general standards for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This guidance also requires disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date on which the financial statements were issued or were available to be issued. Financial statements prepared on a statutory basis are financial statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles (GAAP) according to AU section 623, Special Reports (AICPA, Professional Standards, vol. 1), and in such cases "when the financial statements contain items that are the same as, or similar to, those in the financial statements prepared in conformity with generally accepted accounting principles, similar informative disclosures are appropriate." As such, entities should include disclosures in their financial statements indicating the date through which the entity has evaluated subsequent events, and the basis for that date should be disclosed.

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Risk-Focused Statutory Examinations

Entities are examined for regulatory purposes by the domestic insurance departments for financial solvency. State regulators perform their financial examinations using the risk-focused surveillance approach outlined in the NAIC Financial Condition Examiners Handbook. A need existed for a broader entity-wide business risk assessment, focusing on strategic and operational issues, which enhances the process for evaluating the solvency risks inherent in an insurer's operations. As a result, effective January 1, 2010, state examiners will be required to conduct their examinations using the risk-focused surveillance approach (although many states have already begun conducting examinations using this type of an approach).

This examination approach, which is a key component of establishing and operating an effective risk-focused surveillance process, involves several differences from the traditional, more substantive-based statutory examination process. In particular, under the risk-focused approach, heavy emphasis is placed on the insurer's corporate governance and established risk management practices and processes. At the beginning of the examination, regulators gain an understanding of the corporate governance structure and assess the "tone at the top." In addition, examiners obtain information on the quality of oversight provided by an entity's board of directors. Examiners also evaluate and assess the effectiveness of senior management as part of this corporate governance assessment process. All of this information contributes to an understanding of how an entity identifies, controls, monitors, mitigates, evaluates, and responds to its risks. This assessment helps determine the most significant current and prospective risk areas and assists with determining the amount of substantive examination procedures that state examiners should perform. The examiner's review and consideration of prospective business risk is designed to focus on key risks to future solvency and allows the regulators to tailor their supervision plan to address key risks.

The risk-focused examination is a key component of establishing and operating an effective overall risk-focused surveillance process. Among others, the purposes of the risk-focused examination process include the following:

- Detect early those insurers with potential financial trouble.
- Identify instances of noncompliance with state statutes and regulations.
- Compile the information needed for timely, appropriate regulatory action.
- Provide a clearer methodology for assessing residual risk in each key activity under review with an explanation of how that assessment translates into establishing examination procedures.
- Allow for the assessment of an insurer's risk management processes in addition to those that result in financial statement line item verifications (that is, other than financial statement risks). For example, the effectiveness of an entity's board of directors and other corporate governance activities would provide an introspective look at the operations and quality of the risk management processes of the insurer.
- Allow for the utilization of examination findings to establish, verify, or revise the entity's priority score, determined through the...
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department’s analysis and utilization of the NAIC tools (for example, Scoring System, Alternative Trading Systems results, Insurance Regulatory Information System ratios).

.58 In conjunction with the previously explained objectives, the examiners could review the auditor’s testing of the insurer’s corporate governance environment, recognizing that the extent of documentation pertaining to the insurer’s corporate governance structure and risk mitigation strategies will vary based on the size and structure of the entity and its holding company group. As part of this assessment, the examiners may request to see the auditor’s assessment and testing over various entity-level controls, especially any testing or assessments performed related to the insurer’s enterprise risk management (ERM) structure. Several rating agencies, such as A.M. Best Company and Standard & Poor’s, are emphasizing a review of an entity’s ERM environment and practices and incorporating it into their rating system. If the external auditor has reviewed the ERM practices and the potential relationship to the Committee of Sponsoring Organizations of the Treadway Commission’s ERM framework, the examiner will want to review this documentation. In addition, the examiners also will make inquiries of an entity’s external auditor regarding various substantive testing procedures associated with the auditor’s balance sheet and income statement account testing.

.59 The evaluation of internal controls of an entity’s information technology is a critical element of the risk-focus examination process because the accuracy of the financial statement information depends on the programs and the data files from which they are produced. Smaller entities, as well as Sarbanes-Oxley Act, Section 404 Sarbanes-Oxley compliant entities, will be expected to proactively address information technology risks. Determining the complexity of an entity’s IT environment and determining the extent of work that must be performed to evaluate the controls of the system is not always straightforward. Knowledge gained about systems during previous examinations may no longer be relevant if systems have been refreshed or replaced. An evaluation of IT should consider the elements of internal control in information systems, including general controls over the development of and changes to computer programs, data file access, and application controls over the results of computer processing. The regulators may be particularly interested in the scope of IT testing performed by both the external auditor and the entity on key controls related to both general computer and application controls. In smaller entities, the external auditor’s work in this area also may be considered important because of cost constraints.

.60 Furthermore, the increased understanding in the insurer’s corporate governance and established risk management practices and processes will help determine the most significant financial statement and prospective risk areas. Once the examiners determine the most significant financial reporting areas of focus, they may be interested in reviewing the external auditor’s testing of certain key internal controls related to the entity’s compliance with Sarbanes-Oxley or the early adoption of the Model Audit Rule in order to determine the potential leverage of the external auditor’s working papers. The risk and control matrices that outline the significant risks, key controls, financial statement assertions, testing performed, results of testing, and conclusions reached regarding the design and operating effectiveness of such controls will be of particular interest to the examiners. The regulators likely will want to understand the scope of internal control testing performed by the external auditors and may
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review or reperform certain aspects of the external auditor’s internal control testing in order to establish a basis for reliance. Most entities will want their external auditors to cooperate with the state insurance regulators in order to avoid duplication of effort relating to the testing of key financial statement controls.

Insurance Industry-Related Federal Initiatives

Treasury Department’s Financial Regulatory Reform—Optional Federal Charter

.61 In March 2008, the Treasury Department released its Blueprint for a Modernized Financial Regulatory Structure (the blueprint). The purpose of the blueprint was to present a series of recommendations to Congress for the reform of the U.S. financial regulatory structure. The blueprint was a key part of the Treasury Department’s efforts to improve the competitiveness of the U.S. capital markets in a global marketplace.

.62 On August 11, 2009, the Treasury Department released its Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation, the purpose of which was to propose specific reforms to meet the following five key objectives:

- Promote robust supervision and regulation of financial firms
- Establish comprehensive supervision of financial markets
- Protect consumers and investors from financial abuse
- Provide the government with the tools it needs to manage financial crises
- Raise international regulatory standards and improve international cooperation

.63 The proposed reforms involve significant restructuring of the regulation system, including the creation of two new agencies: the Consumer Financial Protection Agency and National Bank Supervisor Agency and a Financial Services Oversight Council, which is chaired by the Treasury and includes the principal federal financial regulators. The Consumer Financial Protection Agency Act of 2009 excludes applicability to financial activities relating to the business of insurance other than with respect to credit insurance, mortgage insurance, or title insurance. To advance national coordination in the insurance sector, the reforms include creation of an Office of National Insurance (ONI) within the Treasury Department, proposed as the “Office of National Insurance Act of 2009.”

.64 As proposed, the ONI would

- monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system.
- administer the $100 billion Terrorism Risk Insurance Program.
- recommend to the Board of Governors of the Federal Reserve System that it designate an insurer, including affiliates, as an entity subject to regulation as a Tier 1 financial holding company under Section 6 of the Bank Holding Company Act of 1956.

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- coordinate federal efforts and establish federal policy on prudential aspects of international insurance matters, including representing the United States in the International Association of Insurance Supervisors and assisting the secretary in negotiating international insurance agreements.

- possess very limited power to preempt state laws that conflict with international trade agreements, but only to the extent those laws discriminate against foreign-domiciled entities.

- as a key responsibility, collect and analyze data about the insurance markets, using subpoena power, if necessary, and to provide Congress and the White House with regular annual reports commencing September 30, 2011. Smaller entities meeting a minimum size threshold would earn an exemption from the data collection process. The proposal includes specific confidentiality guarantees that the government will not spill any trade secrets. In addition, in advance of requesting and collecting data from the insurance industry, it will coordinate with each relevant state or federal regulator to determine whether the information to be collected is obtainable and timely available from such regulator.

- consult with the states regarding insurance matters of national importance and prudential insurance matters of international importance.

- be led by a director appointed by the Secretary of the Treasury.

- have authority that would extend to all lines of insurance including reinsurance but excluding health insurance.

.65 There has been much debate about the merits of moving to a dual regulatory system for insurers. As of this writing, an optional federal charter (OFC) is not a certainty. However, if one were to be approved by Congress, it is not expected to apply to health insurance but would possibly apply to both property-casualty and life insurance lines of business, although it could ultimately apply only to life insurance. The state-based system would continue for those deciding not to operate at the national level. Legislation has been introduced in both the U.S. House of Representatives and the U.S. Senate supporting the establishment of an OFC.

Health Care Reform

.66 During his campaign and throughout his term of presidency thus far, President Barack Obama has discussed and advocated for health care reform. The health care industry may be changed entirely by his proposed overhaul of the U.S. health care system. The NAIC has expressed its full support in developing federal legislation to ensure affordable health coverage for all Americans and has offered its assistance to Congress in reaching this goal. The NAIC also is encouraging Congress to work with state insurance regulators to learn from past reform and to implement successful health reform initiatives. Although Congress and the administration may take a substantial amount of time to agree on health care reform and its financing, health insurance entities should remain up-to-date on its potential impact on the industry in the future.

Auditors should be aware of and monitor developments in the preceding areas and assess effects, if any, to disclosures, liability accruals, and subsequent events for 2009 fiscal year-ends.

Audit and Attestation Issues and Developments

Audit Risks Arising From Current Economic Conditions

The recent economic conditions and regulatory actions described in this alert may cause additional risk factors that had not existed previously or did not have a material effect on audit clients in prior years. Some risks that may affect an entity in the current economic environment are as follows:

- Constraints on the availability of capital and credit
- Going concern and liquidity issues
- Marginally achieving explicitly stated strategic objectives
- Use of off-balance-sheet financing
- Special-purpose entities, joint ventures, or other complex financing arrangements
- Volatile real estate and business markets
- The credit crisis, which can cause significant measurement uncertainty, including accounting estimates and fair value measurements
- Continued pricing pressure from both reinsurers and insureds

Although many of these risks are not new to businesses, consideration of the ways a client is affected by external forces is part of obtaining an understanding of the entity and its environment and will allow the auditor to plan and perform the audit to address those risks. As noted in paragraph .17 of AU section 312, some possible audit responses to significant risks of material misstatement include increasing the extent of audit procedures, performing procedures closer to year-end, or increasing audit procedures to obtain more persuasive evidence. Additionally, given the constant changing status of economic conditions that could affect your client, auditors should consider modifying audit procedures to ensure that risks are still addressed adequately.

Although it is impossible to predict and include all accounting, auditing, and attestation issues that may affect your engagements, we cover in this alert the primary areas of concern given the current economic conditions. Continue to remain alert to economic, legislative, and regulatory developments, as well as the associated accounting, auditing, and attestation issues as you perform your engagements.

Liquidity Considerations

Technical Questions and Answers (TIS) section 1100.15, "Liquidity Restrictions" (AICPA, Technical Practice Aids), addresses potential accounting and auditing implications when a fund or its trustee imposes restrictions on a nongovernmental entity's ability to withdraw its balance in a money market fund or other short-term investment vehicle. This question and answer section discusses some considerations for when these restriction events occur, such as determining (a) whether any assets subject to these restrictions qualify as cash equivalents or current assets; (b) whether disclosures about the risks and
uncertainties resulting from such restrictions should be made; (c) whether these restrictions may trigger violations of debt covenants and, if so, if that liability should be classified as current; (d) whether the financial statements need to be adjusted if the occurrence of such restriction occurs between the balance sheet date and the issuance date; and (e) whether the restriction events call into question the entity’s ability to continue as a going concern.

.72 Auditors should consider whether any additional disclosures made by management include forward-looking statements that are not required by GAAP and, therefore, may not be audited. Auditors also should consider whether the inability to withdraw funds can pose significant challenges to the entity’s liquidity and, therefore, affect the entity’s ability to continue as a going concern. Restrictions on liquidity also may be an appropriate matter to communicate to those charged with governance. Finally, the auditor should consider if he or she wishes to emphasize any liquidity restrictions in the auditor’s report. For further details, see the question and answer at www.aicpa.org/download/acctstd/TIS1100_15.pdf.

Auditing Alternative Investments

.73 The AICPA practice aid Alternative Investments—Audit Considerations is a useful tool for auditors that focuses on the existence and valuation assertions associated with alternative investments but also discusses general considerations pertaining to auditing alternative investments, management representations, disclosure of certain significant risks and uncertainties, and reporting. As defined in the foreword of the practice aid, alternative investments are investments for which a readily determinable fair value does not exist . . . including private investment funds meeting the definition of an investment company . . . such as hedge funds, private equity funds, real estate funds, venture capital funds, commodity funds, offshore fund vehicles, and funds of funds, as well as bank common/collective trust funds.

.74 You can access the full text of this practice aid on the AICPA’s Web site at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Practice+Aids+and+Tools/alternative_investments.htm.

.75 Given the state of the economy, many funds are imposing limitations on redemptions, and some are even unwinding. As this occurs, the fair value measurements applied to these investments will fall under increased scrutiny and become even more important.

Auditing Fair Value Measurements

.76 In addition to understanding the looming questions relative to fair value accounting, auditors should be aware of audit issues involving fair value accounting. Particular assets, liabilities, and components of equity are measured or disclosed at fair value in the financial statements, and it is management’s responsibility to make the fair value measurements and disclosures. When auditing these fair values to ensure they are in conformity with GAAP, auditors should consult AU section 328, Auditing Fair Value Measurements and Disclosures (AICPA, Professional Standards, vol. 1), which establishes standards and provides guidance for auditors. Specific types of fair value measurements are not covered by AU section 328. For example, when auditing the fair value...

.77 In regard to analyzing the sufficiency of the audit evidence, the strongest audit evidence to support a fair value is an observable market price in an active market. If that is not available, a valuation method should incorporate common market assumptions. If common market assumptions are not available or require significant adjustments, the entity may use its own assumptions. The auditor should obtain an understanding of the entity’s process for determining fair values, as well as whether the fair value measurements and disclosures are in accordance with GAAP. During this testing, the auditor also may identify any possible indicators of impairment. According to paragraph .23 of AU section 328, substantive tests of the fair value measurements may involve (a) testing management’s significant assumptions, the valuation model, and the underlying data; (b) developing independent fair value estimates for corroborative purposes; or (c) reviewing subsequent events and transactions. Paragraph .26 of AU section 328 also notes that when testing the fair value measurements and disclosures, the auditor evaluates whether management’s assumptions are reasonable and reflect, or are not inconsistent with, market information. In relation to FASB ASC 820, this might include whether the market is distressed, whether the transaction was an orderly transaction, the reasonableness of the determination within the fair value hierarchy of inputs, and the reasonableness of the underlying assumptions.

**Fair Values of Securities**

.78 The guidance in AU section 332 relating to auditing the fair value of securities is fairly similar to the guidance in AU section 328; however, the auditor should take note of some items. As previously mentioned, quoted market prices in active markets are the best available audit evidence to support a fair value; however, when they are unavailable and the valuations of securities are obtained from a broker or dealer or another pricing service based on valuation models, the auditor should understand the underlying valuation method used (such as a cash flow projection). These prices also may be based on quoted prices from an active market or other observable inputs that will be a consideration on the auditor’s procedures, as well. The process used by the pricing service in measuring fair value should be evaluated to determine the consistency with the specified valuation method (typically fair value, as defined in FASB ASC 820-10-20). The auditor also may determine that it is necessary to obtain quotes from more than one pricing source based on circumstances, such as an existing relationship between the entity and the valuing entity, which could inhibit objective pricing or underlying valuation assumptions that are highly subjective. In the context of FASB ASC 820, quoted prices in active markets are considered level 1 inputs.

.79 When an entity performs its own valuation, value testing procedures include the following:

- Assessing the reasonableness
- Comparing the assumptions to industry reports or benchmarks
- Assessing the appropriateness of the model
- Calculating the value using his or her own model
- Comparing the fair value with subsequent or recent transactions
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.80 Whether the inputs to the entity’s valuation model are observable determines their characterization as level 2 or level 3 inputs, respectively, within FASB ASC 820. When extensive judgment is needed, consider using a specialist or refer to AU section 342, *Auditing Accounting Estimates* (AICPA, *Professional Standards*, vol. 1). Additionally, when the underlying collateral of a security significantly contributes to its fair value and collectability of the security, evidence of the collateral also should be examined for existence, fair value, transferability, and the investor’s right to the collateral.

.81 Paragraph .19 of AU section 328 also notes that the auditor should evaluate whether the entity’s method for determining fair value measurements is applied consistently and, if so, whether the consistency is appropriate considering possible changes in the environment or circumstances affecting the entity or changes in accounting principles. The auditor also should evaluate management’s conclusions regarding other-than-temporary impairment on its securities. Examples of factors that could cause an other-than-temporary impairment, per paragraph .47 of AU section 332, include the following:

- Fair value is significantly below cost and
  - the decline is attributable to adverse conditions specifically related to the security or to specific conditions in an industry or in a geographic area.
  - the decline has existed for an extended period of time.
  - management does not possess both the intent and the ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.
- The security has been downgraded by a rating agency.
- The financial condition of the issuer has deteriorated.
- Dividends have been reduced or eliminated, or scheduled interest payments have not been made.
- The entity recorded losses from the security subsequent to the end of the reporting period.

.82 Auditors must consider all facts and circumstances when determining if an other-than-temporary impairment has occurred. Additionally, the classification of an entity’s securities is based on management’s intent and ability. The auditor should obtain an understanding of management’s classification process among trading, available-for-sale, and held-to-maturity, as well as consider the classifications in light of the entity’s current financial position.

**Reinsurance Contracts**

.83 Auditors of entities with significant reinsurance contracts may want to request that management state in its representation letter that the auditor has been informed of any side agreements that are part of reinsurance contracts, for the purpose of determining whether the entity has considered properly these agreements in the accounting analysis for the contract. Auditors also may consider the guidance in AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1) (further discussion in the "Consideration of Fraud in a Financial Statement Audit"

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section of this alert), when evaluating these arrangements to identify any of the following:

- Contracts backdated to avoid retroactive reinsurance accounting on coverage of losses that had already been incurred
- Side agreements to reimburse the reinsurer for covered losses or to return profits under a contract in a different accounting period, which may compel accounting accruals
- Linked contracts where losses experienced under one will be reimbursed under another in the future and which should be considered together in the risk transfer analysis
- Contracts whose terms do not make economic sense and indicate a side agreement, or linkage, with another contract that should be considered in the accounting evaluation
- Exclusive reinsurance arrangements with offshore assuming companies that raise consolidation questions
- Commutations where the settlements are not in accordance with contract terms and suggest a noncontractual agreement on the allocation of profits and losses
- Contracts where the risk transfer analysis supporting the accounting evaluation differs materially from and cannot be reconciled to cash flow analyses included in the underwriting file

Reinsurance Recoverables

Consideration should be given to the terms of the reinsurance agreements and the creditworthiness of the reinsurer. Significant payment terms may be material to liquidity and required capital levels. As previously noted, auditors should refer to AU section 341, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1). Due to continued downturns in the market, the auditor should give significant consideration to whether the entity complies with regulatory risk-based capital requirements when evaluating an insurance entity’s ability to continue as a going concern.

Claims Expense and Loss Reserves

Due to the increased number and complexity of transactions surrounding claims and claim expenses, inherent risk surrounding the recording and payout of claims can increase. Auditors should evaluate their client’s response and adherence to criteria and related controls surrounding expenses.

The identification of changes surrounding valuation variables and consideration of their effect on losses are critical audit steps. The evaluation of these factors includes the involvement of specialists and input from various operating departments within the entity, such as marketing, underwriting, actuarial, reinsurance, and legal. Readers should remember that losses are only accrued for events that have occurred; catastrophe reserves are not allowed in anticipation of future events.

AU section 342 states that the auditor should obtain an understanding of how management developed the accounting estimates included in the financial statements (additional discussion in the "Auditing Accounting Estimates" section of this alert). Claims expense and loss reserve estimates are significant.
variables on an insurance entity’s financial statements. Accordingly, regardless
of the approach used to audit claims expense and loss reserve estimates, the
auditor should gain an understanding of how management develops estimates.
Additionally, chapter 4 and appendix A of the AICPA Audit and Accounting
Guide Property and Liability Insurance Entities is an additional source of guid-
ance.

88 Auditors also can refer to AU section 336, Using the Work of a Special-
ist (AICPA, Professional Standards, vol. 1) (additional discussion in the "Using
the Work of a Specialist" section of this alert), as well as noting current prac-
titioner prohibitions and restrictions that exist related to the performance of
nonaudit services for audit clients, including certain actuarial services. Practi-
tioners should be aware of and comply with these prohibitions and restrictions,
including the AICPA, SEC, and Public Company Accounting Oversight Board
(PCAOB) independence rules; new NAIC rules describing qualifications of an
independent CPA included in the Model Audit Rule effective for 2010 statutory
audits; and rules passed by the U.S. Government Accountability Office, state
licensing boards, and others.

Auditing Accounting Estimates

89 As noted in paragraph .04 of AU section 342, the auditor is responsible
for evaluating the reasonableness of accounting estimates made by manage-
ment in the context of the financial statements as a whole. Although this alert
has discussed fair value measurements at length, it is important to remember
many types of accounting estimates exist in client financial statements. Some
examples include loss reserves (additional discussion in the "Claims Expense
and Loss Reserves" section in this alert), the allowance for uncollectible ac-
counts receivable, impairment analysis and estimated useful lives of long lived
assets, valuation allowance for deferred tax assets, and actuarial assumptions
in pension and other postretirement benefit costs.

90 Given the current economic climate, additional skepticism should be
exercised when considering management’s underlying assumptions used in ac-
counting estimates. When evaluating accounting estimates, the auditor should
consider both the subjective and objective factors with professional skepticism.
As discussed in paragraph .09 of AU section 342, key factors and assumptions
that the auditor normally concentrates on include the assumptions that are
significant to the estimate, sensitive to variations, deviations from historical
patterns, or particularly subjective and susceptible to misstatement and bias;
however, it is important to consider whether historical patterns are still appli-
cable.

91 For example, in the current slow market, new patterns may emerge.
In this economic climate, with possible increasing pressure on management to
meet earnings, a key aspect of AU section 342 is for an auditor to determine the
reasonableness of management’s accounting estimates with an extra degree of
professional skepticism. As noted by AU section 316, when assessing audit
differences between client estimates and audit estimates, even if they are indi-
vidually reasonable, an auditor should consider whether these differences are
indicative of possible bias by management. If so, the auditor should reconsider
the estimates as a whole.

92 The auditor should obtain an understanding of how management de-
velops estimates and should employ one of the approaches outlined in para-
graph .10 of AU section 342 in testing that process. In reviewing and testing
management’s process, the auditor may consider identifying controls around this process and determining if the underlying data used for the estimate are reliable and used appropriately. An auditor also may develop an estimate and compare it to management’s estimate. Lastly, the auditor may review subsequent events or transactions occurring prior to the date of the auditor’s report. Further, as noted in AU section 316, hindsight may provide the auditor additional insight into the existence of management bias. For further details on auditing estimates, see AU section 342.

Using the Work of a Specialist

.93 It may be necessary to use a specialist (such as a loss reserve specialist or securities valuation expert) to assist in auditing complex or subjective matters. Examples of matters in which an auditor may engage a specialist are to evaluate the reasonableness of the loss reserves established by management; valuation issues; reasonableness of determination of amounts derived from specialized techniques or models; or implementation of technical requirements, regulations, or legal documents. AU section 336 provides guidance to auditors in using specialists. The guidance in AU section 336 is applicable when the specialist is hired by management or if the auditor engages the specialist. However, if a specialist employed by the auditor’s firm participates in the audit, AU section 311, Planning and Supervision (AICPA, Professional Standards, vol. 1), is applicable rather than AU section 336.

.94 When using the work of a specialist, the auditor should evaluate the specialist’s professional qualifications, obtain an understanding of the nature of the work performed or to be performed, and evaluate the relationship of the specialist to the client in terms of objectivity. Although the appropriateness and reasonableness of the methods and assumptions employed by the specialist are his or her responsibility, the auditor should obtain an understanding of these qualities, test the underlying data provided to the specialist, and evaluate the specialist’s findings in the context of the audit and related assertions in the financial statements.

.95 Readers also should refer to chapter 4 of the AICPA Audit and Accounting Guide Property and Liability Insurance Entities for specific questions and answers relating to situations involving the use of a specialist in management’s determination of loss reserves and the recommended response by the auditor.

Consideration of an Entity’s Ability to Continue as a Going Concern

.96 The consideration of an entity’s ability to continue as a going concern is required in every audit performed under generally accepted auditing standards and is an especially important consideration in the current state of the economy. An entity’s ability to continue as a going concern is affected by many factors related to the current uncertain economy, such as the industry and geographic area in which it operates, the financial health of its customers and suppliers, and financing sources.

.97 As explained by paragraph .02 of AU section 341, the auditor’s evaluation is based on his or her knowledge of relevant conditions and events that exist at or have occurred prior to the date of the auditor’s report. Therefore, this is an ongoing evaluation that extends through the date of the auditor’s report.
The auditor has a responsibility to evaluate whether a substantial doubt exists about the entity’s ability to continue as a going concern for a reasonable period of time. AU section 341 notes that is a period not to exceed one year beyond the date of the financial statements being audited.

Audit teams may find it useful to have preliminary discussions about going concern considerations during engagement planning meetings; however, as noted in AU section 341, it is not necessary to design audit procedures around specifically identifying the possibility of a going concern because results of typical audit procedures should illuminate any indicators. These procedures may consist of analytical procedures, review of subsequent events, review of compliance with financing agreements, review of board minutes, inquiry of legal counsel, and confirmation with related third parties of the details of arrangements to provide or maintain financial support.

Some risks related to the current state of the economy that may influence an entity’s ability to continue as a going concern include the following:

- Lenders may be looking for ways to withdraw from lending relationships.
- Financial support of a related party may not be a feasible mitigating factor, depending on the financial health of that related party.
- An entity’s financial health could be significantly weakened if their suppliers or customers have been strongly affected by the economic crisis.
- Projections provided by entities based on historical data may not be reliable future predictions.
- Some entities may be hesitant to include informative and transparent going concern disclosures.

If the auditor believes a substantial doubt on the entity’s ability to continue as a going concern exists, the next steps are to obtain management’s plans to mitigate the effect of such conditions and then assess the likelihood that these plans can be effectively implemented. Additionally, auditors may consider posing the following questions to help make their assessment on the likelihood of management’s plans to successfully mitigate their going concern risk:

- What is the strategy for extending lines of credit or refinancing any debt coming due? Have any preliminary agreements or discussions occurred?
- If negative operating trends exist, how does management plan on turning them around?
- If turnover of key personnel has occurred, what actions are being taken to replace these positions?
- What is the plan to maintain or increase the liquidity of your balance sheet?
- Do any restrictions exist that could limit management's ability to carry out these plans?
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.102 If, after considering management’s plan, an auditor determines a substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time remains, the auditor should communicate with those charged with governance of the entity, in accordance with AU section 341. In that instance, the auditor also should consider the effects on the entity’s financial statements and the adequacy of the related disclosure, and an explanatory paragraph should be added to the audit report following the opinion paragraph.

.103 Alternatively, if management’s plan mitigates the risk of the entity's ability to continue as a going concern, the auditor should consider disclosing the primary conditions that gave rise to the initial doubt and management's plans. These disclosures are especially important for financial statement users to fully comprehend the entity's financial strength and ability to continue as a going concern.

.104 FASB has undertaken a project that will relocate the guidance related to going concern from the realm of auditing standards to accounting standards. See the "On the Horizon" section of this alert for further details.

Auditor Responsibilities for Subsequent Events

.105 In September 2009, the AICPA issued TIS section 8700.02, "Auditor Responsibilities for Subsequent Events" (AICPA, Technical Practice Aids), which discusses the effects of the company's responsibility to disclose the date through which the subsequent events have been evaluated on the auditor's responsibilities for subsequent events. This TIS section was issued in response to FASB's issuance of FASB Statement No. 165, Subsequent Events (codified in FASB ASC 855). This new guidance is discussed in the "Accounting Issues and Developments" section of this alert. Because the auditor is concerned with events occurring through the date of his or her report that may require adjustment to, or disclosure in, the financial statements, the specific management representations relating to information concerning subsequent events should be made as of the date of the auditor's report. This typically will result in the same date being used for both the auditor's report and the date disclosed by management through which they have evaluated subsequent events. The auditor may consider discussing these dating requirements with management in advance of beginning the audit and include any agreed upon understanding in the engagement letter. The full TIS section can be accessed at www.aicpa.org/download/acctstd/TIS-8700_02.pdf.

Consideration of Fraud in a Financial Statement Audit

.106 AU section 316 is the primary source of authoritative guidance about an auditor's responsibilities concerning the consideration of fraud in a financial statement audit. AU section 316 establishes standards and provides guidance to auditors in fulfilling their responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, as stated in paragraph .02 of AU section 110, Responsibilities and Functions of the Independent Auditor (AICPA, Professional Standards, vol. 1).

.107 Three conditions generally are present when fraud occurs:

- Management or other employees have an incentive or are under pressure, which provides a reason to commit fraud.
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- Circumstances exist (for example, the absence of controls, ineffective controls, or the ability of management to override controls) that provide an opportunity for a fraud to be perpetrated.
- Those involved are able to rationalize committing a fraudulent act.

.108 The current economic situation may result in unexpected losses and possibly cause financing or liquidity difficulties for many entities. Additionally, management may be valuing many illiquid securities using inherently subjective methodologies. These situations may provide management additional opportunity and incentive to commit fraud.

.109 As seen in the news recently, a number of frauds that include the three previously mentioned conditions allegedly have occurred. One of those frauds is that of Bernard Madoff Investment Securities. Auditors should ensure they are properly testing for the existence of assets, such as investments, in this scenario. Additionally, auditors should always gain an understanding of the entity’s business and how profits are made. In the Madoff case, auditors are being probed about failing to question the strong, consistent annual returns by these investment funds that lacked a clear investment strategy. Because of the characteristics of fraud, the auditor’s exercise of professional skepticism is important when considering the risks of material misstatement due to fraud.

.110 Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor’s belief about management’s honesty and integrity. Furthermore, professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred. AU section 316 provides additional information, including ways for the auditor to respond to the risk of material misstatement due to fraud.

Evaluating the Existence of Assets

.111 The Madoff case, and other recent fraud investigations, brings to light a number of risks that continually need to be considered and responded to by management and auditors. Due to the nature of securities and other financial instruments, determining and testing the ownership and existence of investments has become more difficult. Often, securities and other investments purchased on behalf of an entity are held in the name of a broker organization, which may or may not be a custodian; generally, custodians do not obtain a paper document, only an electronic record of the assets.

.112 Some examples of risks inherent in investment transactions that may be relevant when assessing the existence of investments are as follows:

- The assets involved may not be readily available to physical inspection.
- There could be a lack of effective, independent, third party oversight.

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- The information received from a broker organization in the form of monthly statements, or in response to audit confirmation requests, may require further verification to assess its reliability.

- There may be a lack of experience on the part of the client with these types of transactions and, therefore, controls over existence may be nonexistent or poorly designed.

- The transactions may be complex in nature, making them difficult to understand.

.113 Management has a responsibility to design an internal control system that is responsive to the risk of existence of assets (in addition to the valuation of assets). As part of their risk assessment procedures, auditors need to assess those controls and determine if the controls have been implemented. Depending on the results of those assessments, the auditor should design an audit strategy that takes into consideration the entity's controls, including testing those controls, if those controls are to be relied upon and used as part of the auditor's audit evidence regarding the existence assertion. If the auditor's assessment indicates that management's design or operation of controls is not effective, then those deficiencies should be communicated to those charged with governance if the control deficiency is a significant deficiency or material weakness.

.114 Examples of procedures that can be performed by management that are designed to assess the existence of assets could include the following:

- Obtaining through site visits and documenting an understanding of existence controls placed in operation by any service organization that is utilized by the entity and periodically reassessing that understanding

- Obtaining evidence through direct testing or a Statement on Auditing Standards (SAS) No. 70 type 2 report that the service organization's existence controls are appropriately designed and operating effectively

- Inspecting other documentation supporting the entity's interest in the security (for example, correspondence from the broker organization or trustee acknowledging transactions with the fund)

Communication With Those Charged With Governance

.115 In addition to instances in which communication with those charged with governance in other auditing sections is discussed, other select measures are outlined in AU section 380, The Auditor's Communication With Those Charged With Governance (AICPA, Professional Standards, vol. 1), that are specifically relevant during an economic crisis and when measuring fair value. AU section 380 establishes standards and provides guidance on the auditor's communication with those charged with governance. As noted in paragraph .05 of AU section 380, the auditor must communicate with those charged with governance matters related to the financial statement audit that are, in the auditor's professional judgment, significant and relevant to the responsibilities...
of those charged with governance in overseeing the financial reporting process. The auditor should communicate his or her views about the quality of the entity’s significant accounting policies, accounting estimates, and financial statement disclosures.

.116 AU section 341 expands on the applicability of AU section 380 when the auditor has concluded that substantial doubt exists about the entity’s ability to continue as a going concern. In that case, the auditor should communicate to those charged with governance the nature of the events or conditions identified, the possible effect on the financial statements, the sufficiency of the related disclosures, and the effects on the auditor’s report.

Communicating Internal Control Related Matters Identified in an Audit

.117 In October 2008, the AICPA Auditing Standards Board (ASB) issued SAS No. 115, Communicating Internal Control Related Matters Identified in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325). SAS No. 115 amends SAS No. 112, Communicating Internal Control Related Matters Identified in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325A), and further clarifies standards and provides guidance on communicating matters related to an entity’s internal control over financial reporting (internal control) identified in an audit of financial statements.

.118 The new SAS is applicable whenever an auditor expresses an opinion on financial statements (including a disclaimer of opinion), except when the auditor is performing an integrated audit and will be expressing an opinion on the effectiveness of internal control over financial reporting under AT section 501, An Examination of an Entity’s Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements (AICPA, Professional Standards, vol. 1). This new standard is effective for audits of financial statements for periods ending on or after December 15, 2009, with early implementation permitted.

.119 In general, SAS No. 115 retains many of the provisions of SAS No. 112; it provides guidance to (a) enhance the auditor’s ability to identify and evaluate deficiencies in internal control during an audit, and then (b) communicate to management and those charged with governance those deficiencies that the auditor believes are significant deficiencies or material weaknesses.

.120 The key differences between SAS No. 115 and SAS No. 112 lie in the definitions of material weaknesses and significant deficiencies. Under SAS No. 112, the auditor applied criteria of likelihood and magnitude described in that standard to determine if a control deficiency reached the threshold of significant deficiency or material weakness. Under SAS No. 115, the same criteria are used; however, more judgment is allowed for in determining whether a control deficiency is a significant deficiency.

Definitions of Significant Deficiency and Material Weakness

.121 A material weakness is a deficiency, or combination of deficiencies, in internal control, such that a reasonable possibility exists that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. For the purpose of this definition, a reasonable possibility exists when the likelihood of the event is either reasonably
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possible or probable because those terms are used in FASB ASC 450-20-25-1 (originally, these terms appeared in FASB Statement No. 5, Accounting for Contingencies).⁷

.122 A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

The Evaluation Process

.123 Although the auditor is not required to perform procedures specifically to identify deficiencies in internal control, during the course of the audit, the auditor may become aware of deficiencies in the design or operation of the entity’s internal control. The auditor should evaluate the severity of each deficiency in internal control identified during the audit and determine whether the deficiency, individually or in combination with other deficiencies in internal control, rise to the level of significant deficiencies or material weaknesses. The severity of a deficiency in internal control depends on the following:

- The magnitude of the potential misstatement resulting from the deficiency or deficiencies
- Whether a reasonable possibility exists that the entity’s controls will fail to prevent or to detect and correct a misstatement of an account balance or disclosure

.124 The severity of a deficiency does not depend on whether a misstatement actually occurred. If the auditor identifies a deficiency in internal control but has not identified an actual misstatement related to that deficiency, the auditor cannot automatically conclude that the deficiency is not a significant deficiency or a material weakness. If a misstatement has been identified, the auditor should consider the potential for further misstatement in the financial statements being audited.

.125 The AICPA published Audit Risk Alert Communicating Internal Control Related Matters in an Audit—Understanding SAS No. 115 (product no. 022539) to assist in understanding the requirements of this SAS. This Audit Risk Alert provides specific case studies to help determine whether identified control weaknesses would constitute a significant deficiency or material weakness; it can be obtained by calling the AICPA at (888) 777-7077 or visiting www.cpa2biz.com.

.126 The publication A Statutory Framework for Reporting Significant Deficiencies and Material Weaknesses in Internal Control to Insurance Regulators

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⁷ The term reasonably possible as used in the definition of the term material weakness has the same meaning as defined in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 450-20-25-1:

When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. This Statement uses the terms probable, reasonably possible, and remote to identify three areas within that range, as follows:

a. Probable. The future event or events are likely to occur.
b. Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.
c. Remote. The chance of the future event or events occurring is slight.

Therefore, the likelihood of an event is a reasonable possibility when it is reasonably possible or probable.
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(Statutory Framework), developed by members of the AICPA NAIC/AICPA Task Force and the AICPA staff, is intended to provide auditors of insurance entity financial statements with an overview of insurance regulatory developments that may affect the engagements and audits they perform. For purposes other than satisfying Section 11 of the NAIC Model Audit Rule, the auditor also is required to comply with additional reporting requirements of SAS No. 115. The Statutory Framework is an other auditing publication that has no authoritative status; however, it may help the auditor understand and apply the SASs and understand the requirements for internal control related communications to the insurance regulator. The publication can be found on the AICPA Web site at www.aicpa.org/download/acctstd/Statutory_Framework_Jan_11_2009_final.pdf.

Withdrawal of GAAP Hierarchy From Auditing Standards

.127 In August 2009, the ASB voted to withdraw SAS No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles, as amended, from the auditing literature for nonissuers. This SAS was withdrawn as a result of recent pronouncements by FASB, Governmental Accounting Standards Board, and Federal Accounting Standards Advisory Board to incorporate their respective GAAP hierarchies into their respective authoritative literature.

.128 Interpretation No. 3, "The Auditor's Consideration of Management's Adoption of Accounting Principles for New Transactions or Events," of AU section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles, as amended, also will be withdrawn automatically because the ASB did not direct that the interpretation be retained and moved elsewhere within the literature.

.129 The effective date of the withdrawal will be September 2009 to reflect the effective date of the FASB ASC, which is effective for financial statements for interim and annual periods ending after September 15, 2009.

.130 Further information about recent ASB projects and activities is available at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/.

Accounting Issues and Developments

.131 Given the current economic crisis, auditors should consider a number of accounting and financial reporting issues, such as the following:

- Fair value, including fair value measurements in illiquid markets
- Impairment
- Liquidity restrictions

.132 In addition to economic conditions, external forces such as natural disasters significantly affect the insurance industry, especially property and liability insurance. Although many of these risks are not new to business, consideration of the many ways a client is affected by external forces is part of obtaining an understanding of the entity and its environment and will allow the auditor to plan and perform the audit to address those risks.
FASB Statement No. 168

.133 FASB Statement No. 168, as codified in FASB ASC 105, *Generally Accepted Accounting Principles*, is effective for financial statements issued for interim and annual periods ending after September 15, 2009. Nonpublic non-governmental entities that have not previously followed the guidance included in TIS sections 5100.38–.76, "Revenue Recognition" (AICPA, *Technical Practice Aids*), which is now included in FASB ASC as authoritative, should account for the adoption of that guidance as a change in accounting principle, on a prospective basis, for revenue arrangements entered into or materially modified in those fiscal years beginning on or after December 15, 2009, and interim periods within those years. If an accounting change results from the application of this guidance, an entity should disclose the nature and reason for the change in accounting principle in their financial statements. This new standard flattens the GAAP hierarchy to two levels: one that is authoritative (in FASB ASC) and one that is nonauthoritative (not in FASB ASC). Exceptions include all rules and interpretive releases of the SEC under the authority of federal securities laws, which are sources of authoritative GAAP for SEC registrants, and certain grandfathered guidance having an effective date before March 15, 1992. This statement creates FASB ASC 105.

.134 FASB Statement No. 168 is the final standard that will be issued by FASB in that form. It was added to FASB ASC through Accounting Standards Update (ASU) No. 2009-02 on June 30, 2009. No new standards in the form of statements, staff positions, Emerging Issues Task Force (EITF) abstracts, or AICPA accounting Statement of Positions, for example, will be issued. Instead, FASB will issue ASUs. FASB will not consider Accounting Standards Updates as authoritative in their own right. Instead, they will serve only to update FASB ASC, provide background information about the guidance, and provide the basis for conclusions on changes made to FASB ASC.

FASB ASC

.135 On the effective date of FASB Statement No. 168, FASB ASC became the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the SEC. At that time, FASB ASC superseded all then-existing, non-SEC accounting and reporting standards for nongovernmental entities. Once effective, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. This change will affect accountants and auditors alike.

.136 FASB ASC is a major restructuring of accounting and reporting standards designed to simplify user access to all authoritative U.S. GAAP by providing the authoritative literature in a topically organized structure. FASB ASC disassembled and reassembled thousands of nongovernmental accounting pronouncements (including those of FASB, the EITF, and the AICPA) to organize them under approximately 90 topics. FASB ASC includes all accounting standards issued by a standard setter within levels A–D of the current U.S. GAAP hierarchy. FASB ASC also includes relevant portions of authoritative content issued by the SEC, as well as select SEC staff interpretations and administrative guidance issued by the SEC; however, FASB ASC is not the official source of SEC guidance and does not contain the entire population of SEC rules, regulations, interpretive releases, and staff guidance.
FASB ASC is not intended to change U.S. GAAP or any requirements of the SEC; rather, it is part of FASB’s efforts to reduce the complexity of accounting standards and also to facilitate international convergence. Moreover, FASB ASC does not include governmental accounting standards. The purposes behind the codification project include the following:

- Reduce the amount of time and effort required to solve an accounting research issue
- Mitigate the risk of noncompliance with standards through improved usability of the literature
- Provide accurate information with real-time updates as new standards are released
- Assist FASB with the research and convergence efforts required during the standard setting process
- Become the authoritative source of literature for the completed eXtensible Business Reporting Language taxonomy
- Clarify that guidance not contained in FASB ASC is not considered authoritative

FASB ASC uses a topical structure in which guidance is organized into areas, topics, subtopics, sections, and subsections. These terms are defined as follows:

**Areas.** The broadest category in FASB ASC, which represent a grouping of topics.

**Topics.** The broadest categorization of related content, which correlate with the International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs).

**Subtopics.** Subsets of a topic, which are generally distinguished by type or scope.

**Sections.** Categorization of the content, into such groups as recognition, measurement, or disclosure. The sections’ structure correlates with the IASs and IFRSs.

**Subsections.** Further segregation and navigation of content below the section level.

FASB ASC topics, subtopics, and sections are numerically referenced. This effectively organizes the content without regard to the original standard setter or standard from which the content was derived. An example of the numerical referencing is FASB ASC 305-10-05, in which 305 is the Cash and Cash Equivalents topic, 10 represents the “Overall” subtopic, and 05 represents the “Overview and Background” section. Constituents are encouraged to begin using FASB ASC, which can be accessed at http://asc.fasb.org/home. To read more about FASB ASC, including recent developments and updates, please see the AICPA’s dedicated FASB ASC Web site at www.aicpa.org/Professionals/Resources/Accounting+and+Auditing/FASB+Accounting+Standards+Codification/.

**Referencing FASB ASC in Your Documentation**

You should consider how and when your entity will begin referencing FASB ASC in your documentation (policy and procedures, technical
memorandums, financial statements and filings, engagement working papers, and so on). It is only prudent to reflect current GAAP in your documentation. The FASB Notice to Constituents (NTC) includes a section on referencing FASB ASC in footnotes and other documents. In this notice, FASB encourages the use of plain English to describe broad topic references in the future. For example, to refer to the requirements of the Derivatives and Hedging topic, they suggest a reference similar to "as required by the Derivatives and Hedging topic of the FASB Accounting StandardsCodification."

On the other hand, they do suggest using the detailed numerical referencing system in working papers, articles, textbooks, and related items. The NTC also provides some detailed examples of how to reflect the numerical referencing in such documents. However, if you need to reference certain grandfathered guidance not included in FASB ASC (a listing can be found in FASB Statement No. 168), use of the old terminology would still be appropriate. The following are some examples of how and when to implement the new FASB referencing system:

- **Nonpublic entities.** For nonpublic entities without interim filings, preparers choosing to reference specific accounting guidance in financial statements would make those references to FASB ASC for the first annual period ending after September 15, 2009. For example, a nonpublic entity with a July 31, 2009, year-end would not reference FASB ASC in its financial statements, but a nonpublic entity with a December 31, 2009, year-end would reference FASB ASC in its financial statements.

- **Public entities.** The SEC recently shared with the Center for Audit Quality (CAQ) SEC Regulations Committee some views on referencing FASB ASC in financial statements. For interim and annual financial statements for periods ending after September 15, 2009, the SEC stated that any references to specific elements of GAAP should use the FASB ASC reference. Therefore, a public entity filing financial statements for the quarter ended September 30, 2009, should reference FASB ASC in its financial statements. In addition, the SEC stated that references to specific GAAP (FASB ASC references) should be on a consistent basis for all periods presented. However, the SEC has encouraged companies to make financial statements more useful to users by drafting financial statement disclosures to avoid specific GAAP references and to more clearly explain accounting concepts.

Also, because FASB ASC is not intended to change GAAP, the consistent use of references to only FASB ASC for all periods presented (including periods before the authoritative release of FASB ASC) is appropriate.

It is prudent to expect that audit, attest, or compilation and review working papers associated with financial statements for a period ending after September 15, 2009, also would reflect FASB ASC because the underlying financial statements, which are the subjects of those engagements, reference FASB ASC.

However, if your entity will continue to follow grandfathered guidance not included in FASB ASC, it would still be appropriate to reference those standards (and not FASB ASC). The listing of all grandfathered guidance can
be found in FASB Statement No. 168, as well as a listing of examples of grandfathered guidance. Examples of disclosures using references to FASB ASC can be found at the AICPA’s dedicated FASB ASC Web site: www.aicpa.org/Professional+Resources/Accounting+and+Auditing/FASB+Accounting+Standards+Codification/.

Consolidation of Variable Interest Entities

In June 2009, FASB issued FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R),8 which changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity’s purpose and design and a company’s ability to direct the activities of the entity that most significantly impact the entity’s economic performance.

This statement also amends FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities—an interpretation of ARB No. 51 (codified primarily at FASB ASC 810-10), to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity, which was based on determining which enterprise absorbs the majority of the entity’s expected losses, receives a majority of the entity’s expected residual returns, or both.

Entities will be required to provide additional disclosures about involvement with variable interest entities and any significant changes in risk exposure due to that involvement. Entities also will be required to disclose how involvement with a variable interest entity affects the entity’s financial statements.

FASB Statement No. 167 retains the scope of FASB Interpretation No. 46(R) with the addition of entities previously considered qualifying special purpose entities because the concept of these entities was eliminated in FASB Statement No. 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140.9

This statement is effective as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited.

Accounting for Transfers of Financial Assets

Also in June 2009, FASB issued FASB Statement No. 166, which is a revision to FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125 (which was codified in FASB ASC 860, Transfers and Servicing), and will require more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a qualifying special purpose entity, changes the requirements for

8 At the date of this writing, this guidance has not yet been included in FASB ASC. Readers are encouraged to visit the FASB ASC Web site at http://asc.fasb.org/home and monitor updates.

9 See footnote 8.
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derecognizing financial assets, and requires additional disclosures. The purpose
of this statement is to improve the relevance, representational faithfulness, and
comparability of the information that a reporting entity provides in its finan-
cial statements about a transfer of financial assets; the effects of a transfer on
its financial position, financial performance, and cash flows; and a transferor’s
continuing involvement, if any, in transferred financial assets.

Additionally, on and after the effective date, the concept of a qualifying
special-purpose entity is no longer relevant for accounting purposes. Therefore,
formerly qualifying special purpose entities (as defined under previous account-
ing standards) should be evaluated for consolidation by reporting entities on
and after the effective date in accordance with the applicable consolidation
guidance.

FASB Statement No. 166 must be applied as of the beginning of each
reporting entity’s first annual reporting period that begins after November 15,
2009, for interim periods within that first annual reporting period and for in-
term and annual reporting periods thereafter. Earlier application is prohibited.
This statement must be applied to transfers occurring on or after the effective
date; however, the disclosure provisions should be applied to transfers that
occurred both before and after the effective date.

Subsequent Events

In May 2009, FASB issued FASB Statement No. 165, which has been
codified in FASB ASC 855, and is effective for interim and annual periods ending
after June 15, 2009. This statement is intended to establish general standards
of accounting for and disclosure of events that occur after the balance sheet
date but before financial statements are issued or are available to be issued.
It requires the disclosure of the date through which an entity has evaluated
subsequent events and the basis for that date (that is, whether that date rep-
resents the date the financial statements were issued or were available to be
issued). The purpose of this disclosure is to alert all users of financial state-
ments that an entity has not evaluated subsequent events after that date in
the set of financial statements being presented.

In particular, this statement sets forth the following:

- The period after the balance sheet date during which management
  of a reporting entity should evaluate events or transactions that
  may occur for potential recognition or disclosure in the financial
  statements
- The circumstances under which an entity should recognize events
  or transactions occurring after the balance sheet date in its finan-
  cial statements
- The disclosures that an entity should make about events or trans-
  actions that occurred after the balance sheet date

FASB states that this statement should not result in significant
changes in current practice with regard to the subsequent events that an entity
reports, either through recognition or disclosure, in its financial statements.
Further, in September 2009, the AICPA issued two TIS sections regarding
this guidance. TIS section 8700.01, "Effect of FASB ASC 855 on Accounting
Guidance in AU Section 560" (AICPA, Technical Practice Aids), notes that
preparers of financial statements for nongovernmental entities are required to
follow the accounting guidance in FASB ASC 855. Additionally, the accounting
guidance contained in AU section 560 would no longer be applicable to audits of nongovernmental entities. TIS section 8700.02 is discussed in the "Audit and Attestation Issues and Developments" section of this alert. Both TIS sections can be accessed at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Practice+Aids+and+Tools/Recently+Issued+Technical+Practice+Aids.htm.

Fair Value

157 Among the causes cited for the economic crisis, the guidance in FASB ASC 820 (formerly FASB Statement No. 157) has received a great deal of attention. FASB ASC 820-10-20 defines fair value and establishes a framework for measuring fair value; however, it does not dictate when an entity must measure something at fair value, nor does it expand the use of fair value in any way. The need to understand fair value accounting has increased in importance as alternative investments increased in popularity and complexity.

158 This guidance defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." A contention with this guidance is the difficulty of applying the existing guidance in an illiquid or distressed market, such as the current one. This difficulty has the potential to allow inconsistencies in application by accountants and auditors. Prior to the issuance of FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly, which is codified in FASB ASC 820-10, the areas of the fair value guidance that related to measuring fair value in an illiquid market were limited to the following mentions:

- "An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale)."
- "Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that are . . . willing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so."
- "For example, a transaction price might not represent the fair value of an asset or liability at initial recognition if . . . [t]he transaction occurs under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty."

159 Both the SEC and FASB took notice of constituents' desire for further guidance. In September 2008, the SEC issued SEC Office of the Chief Accountant and FASB Staff Clarifications on Fair Value Accounting to provide immediate clarifications on fair value in illiquid markets for preparers and auditors until FASB was able to provide additional interpretative guidance.

Determining Whether a Market Is Not Active and a Transaction Is Not Distressed

160 On April 9, 2009, FASB issued FSP FAS 157-4, which is codified in FASB ASC 820-10. The purpose of this FSP is to provide additional guidance in
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the application of fair value accounting in an inactive market; it supersedes FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. Among other points, the new guidance

- affirms that the objective of fair value when the market for an asset is not active is the price that would be received to sell the asset in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions (that is, in the inactive market).
- clarifies and includes additional factors for determining whether there has been a significant decrease in market activity for an asset when the market for that asset is not active.
- requires an entity to base its conclusion about whether a transaction was not orderly on the weight of the evidence.
- includes an example that provides additional explanation on estimating fair value when the market activity for an asset has declined significantly.
- requires an entity to disclose a change in valuation technique (and the related inputs) resulting from the application of this guidance and to quantify its effects, if practicable, by major category.
- applies to all fair value measurements when appropriate.

.161 This new guidance shall be effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. Early adoption is permitted for periods ending after March 15, 2009. Earlier adoption for periods ending before March 15, 2009, is not permitted. If a reporting entity elects to adopt early either FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments, which was primarily codified in FASB ASC 310-55, 325-40, and 320-10, or FSP FAS 107-1, and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments, which has been codified in FASB ASC 270-10-50-1, 320-10, and 825-10-50, the reporting entity also is required to adopt this FSP early. Additionally, if the reporting entity elects to adopt early, FSP FAS 115-2 and FAS 124-2 also must be adopted early. This FSP does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, this FSP requires comparative disclosures only for periods ending after initial adoption.

Interim Disclosures About Fair Value of Financial Instruments

.162 On April 9, 2009, FASB released FSP FAS 107-1 and APB 28-1, which has been codified in FASB ASC 270-10-50-1, 320-10, and 825-10-50. This guidance relates to fair value disclosures for any financial instruments that are not currently reflected on the balance sheet of companies at fair value. Prior to this issuance, fair values for these assets and liabilities were disclosed only once a year. The guidance requires these disclosures to be made on a quarterly basis, providing qualitative and quantitative information about fair value estimates for all those financial instruments not measured on the balance sheet at fair value. The guidance

- applies to all financial instruments, as defined by the FASB ASC glossary and discussed in FASB ASC 825-10-50-8.
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- applies to the financial statements of publicly traded companies, as defined in the FASB ASC glossary, for interim and annual reporting periods.

- requires an entity to disclose the methods and significant assumptions used to estimate the fair value of financial instruments and shall describe changes in methods and significant assumptions, if any, during the period.

.163 This guidance shall be effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity may adopt early only if it also elects to adopt early FSP FAS 157-4 and FSP FAS 115-2 and FAS 124-2. This FSP does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, this FSP requires comparative disclosures only for periods ending after initial adoption.

Measuring Liabilities at Fair Value

.164 On August 27, 2009, FASB issued ASU No. 2009-05, Measuring Liabilities at Fair Value. This ASU was issued to increase the consistency in the application of FASB ASC 820 to liabilities because many constituents had expressed concern. This ASU applies to all entities that measure liabilities at fair value under FASB ASC 820 and amends sections of FASB ASC 820-10.

.165 This ASU states that, in circumstances in which a quoted price in an active market for the identical liability is not available, fair value of the liability must be measured by either (a) a valuation technique that uses the quoted price of the identical liability when traded as an asset or quoted prices for similar liabilities, or similar liabilities when traded as assets, or (b) another valuation technique that is consistent with the principles of FASB ASC 820, such as an income approach or a market approach. Further, if a restriction on the transference of the liability exists, the ASU clarifies that an entity is not required to factor that in to the inputs of the fair value determination. Lastly, the ASU also clarifies that a quoted price in an active market for the identical liability, or an unadjusted quoted price in an active market for the identical liability, when traded as an asset, are level 1 measurements within the fair value hierarchy. The guidance in this ASU is effective for the first reporting period (including interim periods) beginning after issuance. The full text of the ASU can be accessed from FASB’s Web site at www.fasb.org.

Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)

.166 In September 2009, FASB issued ASU No. 2009-12, Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent). This guidance was issued because of the complexities and practical difficulties in estimating the fair value of alternative investments. It is applicable to all reporting entities that hold an investment that is required or permitted to be measured or disclosed at fair value on a recurring or nonrecurring basis, and as of the reporting entity’s measurement date, if the investment both

- does not have a readily determinable fair value. The FASB ASC glossary states that an equity security has a readily determinable fair value if it meets any of the following conditions:
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— The fair value of any equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the SEC or in the over-the-counter (OTC) market, provided that those prices or quotations for the OTC market are publicly reported by NASDAQ or by Pink Sheets LLC. Restricted stock meets that definition if the restriction terminates within one year.

— The fair value of an equity security traded only in a foreign market is readily determinable if that foreign market is of a breadth and scope comparable to one of the U.S. markets referred to previously.

— The fair value of an investment in a mutual fund is readily determinable if the fair value per share (unit) is determined and published and is the basis for current transactions.

• is in an entity that has all of the attributes specified in FASB ASC 946-10-15-2 or, if one of those attributes are not met, is in an entity for which it is industry practice to issue financial statements using guidance that is consistent with the measurement principles in FASB ASC 946, Financial Service—Investment Companies.

.167 As a practical expedient, this ASU permits a reporting entity to measure the fair value of an investment within its scope on the basis of the net asset value (NAV) per share of the investment (or its equivalent) if the NAV is calculated in a manner consistent with the measurement principles of FASB ASC 946 as of the reporting entity’s measurement date, including measurement of all or substantially all of the underlying investments of the investee in accordance with FASB ASC 820. If the practical expedient is used, certain attributes of the investment (such as restrictions on redemption) and transaction prices from principal-to-principal or brokered transactions will not be considered in measure the investment’s fair value.

.168 This ASU also requires disclosures by major category of investment about the attributes of investments, such as the nature of any restrictions on the investor’s ability to redeem its investments at the measurement date, any unfunded commitments, and the investment strategies of the investees. The major category of investment is required to be determined based on the guidance in FASB ASC 320-10-50-1B. These disclosures are required for all investments within the scope of this ASU. The ASU adds an example of its required disclosures in FASB ASC 820-10-55-64A.

.169 These amendments are effective for interim and annual periods ending after December 15, 2009 and are included in FASB ASC 820-10. Early application is permitted in financial statements for earlier and interim and annual periods that have not been issued. An entity may elect to early adopt the measurement amendments of this ASU and defer the adoption of the disclosure provisions of FASB ASC 820-10-50-6A until periods ending after December 15, 2009. An AICPA practice aid, Alternative Investments—Audit Considerations, also is available and is a useful tool for auditors. It focuses on the existence and valuation assertions associated with alternative investments. See the "Auditing Alternative Investments" section of this alert for further details.
Other-Than-Temporary Impairment

Determining when an investment is other-than-temporarily impaired is another topic that has received increased attention in today’s economic environment. FSP FAS 115-1 and FAS 124-1, as amended by FSP FAS 115-2 and FAS 124-2, is codified in several topics in FASB ASC, including FASB ASC 320, Investments—Debt and Equity Securities, and FASB ASC 325, Investments—Other. This guidance addresses the determination of when an investment is considered impaired, whether the impairment is other-than-temporary, and the measurement of the impairment loss. Also included in this amended guidance are accounting issues to be considered subsequent to the recognition of other-than-temporary impairments and related disclosures about unrealized losses as a result of the other-than-temporary impairment. This amended guidance applies to (a) debt and equity securities within the scope of FASB ASC 320; (b) debt and equity securities within the scope of FASB ASC 958-320 that are held by an investor that reports a performance indicator; and (c) equity securities not within the scope of FASB ASC 320 and 958-320 and not accounted for under the equity method, pursuant to FASB ASC 323, Investments—Equity Method and Joint Ventures. The auditor also should be alert for all types of assets that can become impaired, including goodwill, deferred tax assets, and real property. Given the current economic situation, entities should be alert to values of many types of assets on the balance sheet and possible impairment issues. Readers should consult the appropriate accounting requirements for further information. For the full text of FSP FAS 115-1 and FAS 124-1, as amended, please visit the FASB Web site at www.fasb.org.

Recognition and Presentation of Other-Than-Temporary Impairments

On April 9, 2009, FASB released FSP FAS 115-2 and FAS 124-2, which was primarily codified in FASB ASC 310-30, 320-10, and 325-40. The purpose of this FSP is to bring greater consistency to the timing of impairment recognition and provide greater clarity to investors about the credit and non-credit components of impaired debt securities that are not expected to be sold. Among other points, the FSP

- limits its changes to existing guidance for determining whether an impairment is other than temporary to debt securities.
- replaces the existing requirement that the entity’s management assert that it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert that it does not have the intent to sell the security, or it is more-likely-than-not it will not have to sell the security before recovery of its costs basis.
- incorporates examples of factors from existing literature that should be considered in determining whether a debt security is other-than-temporarily impaired and how those factors interact with the requirement to assert that the entity does not intend to sell the security, and it is more-likely-than-not that the entity will not have to sell the security before recovery of its cost basis.
- requires an entity to recognize the credit component of an other-than-temporarily impairment of a debt security in earnings and the remaining portion in other comprehensive income, when an entity does not intend to sell the security and it is more-likely-than-not
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that the entity will not have to sell the security before recovery of its cost basis.

- requires an entity to recognize noncredit losses on held to maturity debt securities in other comprehensive income and amortize that amount over the remaining life of the security with no effect on earnings, unless the security is subsequently sold or additional credit losses exist.

- includes guidance for debt securities accounted for in accordance with FASB ASC 310-30, stipulating that credit losses should be measured on the basis of an entity’s estimate of the decrease in expected cash flows, including those that result from an increase in expected prepayments.

- clarifies that existing premiums or discounts and subsequent changes in estimated cash flows or fair value should continue to be accounted for in accordance with existing guidance (for example, EITF Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets,” which was primarily codified in FASB ASC 325-40).

- requires an entity to present the total other-than-temporary impairment in the statement of earnings with an offset for the amount recognized in other comprehensive income.

- requires an entity to present separately in the financial statement where the components of accumulated other comprehensive income are reported and amounts recognized therein related to held to maturity and available for sale debt securities, for which a portion of an other-than-temporary impairment has been recognized in earnings.

- modifies the disclosure requirements of certain debt and equity securities to require an entity to provide the following:
  
  — The cost basis of available for sale and held to maturity debt securities by major security type

  — The methodology and key inputs, such as performance indicators of the underlying assets in the security, loan to collateral value ratios, third party guarantees, levels of subordination, and vintage, used to measure the portion of an other-than-temporary impairment related to credit losses by major security type

  — A tabular rollforward of the amount related to credit losses recognized in earnings for debt securities

- modifies previous guidance to require that major security classes be based on the nature and risks of the security and additional types of securities to be included in the list of major security types listed in FASB ASC 942-320-50-2.

- requires the preceding additional disclosures, as well as all prior existing disclosures, for interim periods.

.172 The guidance is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. Earlier adoption for periods ending before March 15, 2009,
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is not permitted. As discussed previously, if an entity elects to adopt early either FSP FAS 157-4 or FSP FAS 107-1 and APB 28-1, the entity also is required to adopt this FSP early. Additionally, if an entity elects to adopt this FSP early, it is required to adopt FSP FAS 157-4. This FSP does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, this FSP requires comparative disclosures only for periods ending after initial adoption. More information is available at www.fasb.org.

.173 Under SAP, in determining whether impairment has occurred on an investment under the NAIC Accounting Practices and Procedures Manual, management needs to consider all available evidence in determining whether an impairment exists, and if that impairment is other than temporary. SSAP No. 99 adopts the guidance in paragraph 16 of FSP FAS 115-1 and FAS 124-1 and provides guidance to account for the amortization or accretion of debt securities after an other-than-temporary impairment.

Accounting for Losses Due to Fraud

.174 A topic of discussion for management and their auditors is the manner in which losses due to fraud are reflected in the financial statements. Because no accounting standard exists that provides specific guidance on accounting for losses due to fraud, application of professional judgment in this matter can lead to different results. For example, some clients have determined that the losses should be reported in the current period, when the entity became aware of the fraud, whereas others are opting for a restatement of the financial statements for one or more prior periods because they believe the loss in value occurred in a prior period and, therefore, an adjustment is appropriate. It is important that the auditor understand how the decision was reached and that proper disclosure be made in the financial statements.

.175 Auditors also may consider whether management has properly disclosed or recognized any liability associated with the potential clawback of distributions received from the perpetrator of Ponzi schemes. In the case of Bernard Madoff Investment Securities, a possibility exists that the bankruptcy trustee may file lawsuits to recover funds distributed to investors prior to the discovery of the fraud for the purpose of redistributing the funds. Management, in conjunction with appropriate legal counsel, should determine the probability and result of such a lawsuit and disclose or accrue a potential liability, as required by FASB ASC 450, Contingencies.

Liquidity Restrictions

.176 As discussed in the "Audit and Attestation Issues and Developments" section of this alert, TIS section 1100.15 addresses the potential accounting and auditing implications when a fund or its trustee imposes restrictions on a nongovernmental entity’s ability to withdraw its balance in a money market fund or other short-term investment vehicle.

Prospective Unlocking TPA

.177 In December 2008, the AICPA staff, assisted by industry experts, released a technical question and answer (TIS section 6300.36, "Prospective Unlocking" [AICPA, Technical Practice Aids]), on a financial accounting issue related to prospective unlocking of FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises, long-duration insurance contracts. The question relates to whether an insurance entity is permitted to "unlock" its
original FASB Statement No. 60 assumptions after contract inception for collected, approved, or expected premium rate increases for the contracts previously described in situations other than in premium deficiency.

The question and answer can also be found on the accounting standards part of the AICPA Web site at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/recent_tpas.htm.

Convergence With IFRSs

Since the signing of the Norwalk Agreement by FASB and the International Accounting Standards Board (IASB), the bodies have had a common goal—one set of accounting standards for international use. In this agreement, each body acknowledged its commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. FASB and the IASB have undertaken several joint projects, which are being conducted simultaneously in a coordinated manner to further the goal of convergence of U.S. GAAP and IFRSs. These ongoing joint projects address the conceptual framework, business combinations, financial statement presentation, and revenue recognition. The "On the Horizon" section of this alert discusses these joint projects. For more information, visit www.fasb.org and www.iasb.org.

IFRSs Roadmap

In August 2008, the SEC voted to publish for public comment a proposed roadmap that could lead to the use of IFRSs by U.S. issuers beginning in 2014. The SEC would make a decision in 2011 on whether adoption of IFRSs is in the public interest and would benefit investors. The proposed multiyear plan sets out several milestones that, if achieved, could lead to the use of IFRSs by U.S. issuers in their filings with the SEC. The top 20 companies in each industry, as determined by market capitalization, could elect to begin filing IFRSs financial statements for fiscal periods ending after December 15, 2009. If, in 2011, the SEC adopts IFRSs for all filers, the roadmap suggests mandatory filing for large accelerated filers beginning in 2014, accelerated filers in 2015, and nonaccelerated filers in 2016. The extended comment period ended in April 2009.

The proposed roadmap sets forth seven milestones that will influence the SEC’s decision to adopt IFRSs for all filers. These milestones relate to the following:

- Improvements in accounting standards
- Accountability and funding of the International Accounting Standards Committee Foundation (IASC)
- Improvement in the ability to use interactive data for IFRSs reporting
- Education and training relating to IFRSs
- Limited early use of IFRSs when this would enhance comparability for U.S. investors
- Anticipated timing of future rulemaking by the SEC
- Implementation of the mandatory use of IFRSs by U.S. issuers

Additionally, the roadmap discusses two alternatives for U.S. issuers that elect to use IFRSs to disclose U.S. GAAP information. Proposal A suggests
that a U.S. issuer who elects to file IFRSs financial statements would provide the reconciling information from U.S. GAAP to IFRSs called for under IFRS 1, *First-time Adoption of International Financial Reporting Standards*, in a footnote to its audited financial statements. This information would include the restatement of and reconciliation from the prior year's financial statements and related disclosures. Proposal B suggests that U.S. issuers that elect to file IFRSs financial statements would provide the reconciling information from U.S. GAAP to IFRSs required under IFRS 1 and also would disclose on an annual basis certain unaudited supplemental U.S. GAAP financial information covering a three year period. This unaudited supplemental financial information would be in the form of a reconciliation from IFRSs to U.S. GAAP.

.183 The roadmap does not address how the SEC would mandate IFRSs; however, the SEC noted that an option would be for the FASB to continue to be the designated standard setter for purposes of establishing the financial reporting standards in issuer filings with the Commission. In this option our presumption would be that the FASB would incorporate all provisions under IFRS, and all future changes to IFRS, directly into generally accepted accounting principles as used in the United States. This type of approach has been adopted by a significant number of other jurisdictions when they adopted IFRS as the basis of financial reporting in their capital markets.


.185 Since the issuance of the roadmap, new SEC Chairman Schapiro has indicated she favors a slowdown of the U.S. adoption of global accounting rules. Users are encouraged to closely monitor the progress of this initiative.

**International Financial Reporting Standard for Small and Medium-sized Entities**

.186 In July 2009, the IASB issued *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*. *IFRS for SMEs* is an approximately 230-page significantly reduced and simplified version of full IFRSs. In creating *IFRS for SMEs*, the IASB eliminated many accounting topics that are not generally relevant to private companies (for example, earnings per share and segment reporting), easing the financial reporting burden on private companies through a cost-benefit approach. *IFRS for SMEs* is a self-contained global accounting and financial reporting standard applicable to the general purpose financial statements of, and other financial reporting by, entities that are known in many countries as SMEs.

.187 *IFRS for SMEs* is intended to be used by entities that publish general purpose financial statements for external users and do not have public accountability. Under the IASB’s definition, an entity has public accountability if it files or is in the process of filing its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market or if it holds assets in a fiduciary capacity for a broad group of outsiders. Examples of entities that hold assets in a fiduciary capacity include banks, insurance entities, brokers and dealers in securities, pension funds, and mutual funds. It is not the IASB’s intention to exclude entities that hold assets in a fiduciary capacity for reasons incidental to

ARA-INS .187
their primary business (for example, travel agents, schools, and utilities) from utilizing IFRS for SMEs.

.188 Unlike public companies, U.S. private companies are not required to use a particular basis of accounting when preparing their financial statements. The factors that drive a private company’s choice of which financial accounting and reporting framework to follow in preparing its financial statements depend upon each company’s objectives and the needs of their financial statement users. Currently, private companies in the United States can prepare their financial statements in accordance with U.S. GAAP, as promulgated by FASB; an other comprehensive basis of accounting, such as cash or tax basis; or full IFRSs, among others. Now, with the issuance of IFRS for SMEs, U.S. private companies have an additional option.

.189 Some U.S. private companies may find the simplified IFRS for SMEs an attractive alternative to the more complicated and voluminous U.S. GAAP. Those private companies may find IFRS for SMEs to be a more relevant and less costly financial accounting and reporting standard than U.S. GAAP. Being based on full IFRSs and missing many accounting topics, IFRS for SMEs, therefore, differs from U.S. GAAP in a variety of areas. Some of the key differences under IFRS for SMEs are the following:

- Disclosures are simplified in a number of areas including pensions, leases, and financial instruments.
- Last in, first out (LIFO) is prohibited.
- Goodwill and indefinite life intangible assets are amortized over a period not exceeding 10 years.
- Depreciation is based on a components approach.
- The temporary difference approach to income tax accounting is simplified.
- Reversal of impairment charges, if certain criteria are met, is allowed.
- Accounting for financial assets and liabilities makes greater use of cost.

.190 Some key challenges that may be present in choosing to use IFRS for SMEs include understanding the differences between IFRS for SMEs and U.S. GAAP, the willingness of financial statement users to accept financial statements prepared under IFRS for SMEs, working with and accepting a more principles-based set of accounting standards compared to the more rules-based U.S. GAAP, the impact on taxes and tax planning strategies, and the impact on financial reporting metrics.

.191 The AICPA welcomes the introduction of IFRS for SMEs in the United States. Private companies should be allowed to choose the financial accounting and reporting framework that best suits their objectives and the needs of their financial statement users. IFRS for SMEs represents another valuable financial accounting and reporting option for private companies to consider using, depending upon their unique circumstances.

.192 In May 2008, the AICPA Governing Council voted to recognize the IASB as an accounting body for purposes of establishing international financial accounting and reporting principles. This amendment to appendix A of AICPA Rule 202, Compliance With Standards (AICPA, Professional Standards, vol. 2, ARA-INS .188
ET sec. 202 par. .01), and Rule 203, Accounting Principles (AICPA, Professional Standards, vol. 2, ET sec. 203 par. .01), gives AICPA members the option to use IFRSs as an alternative to U.S. GAAP. As such, a key professional barrier to using IFRSs and, therefore, IFRS for SMEs has been removed. CPAs may need to check with their state boards of accountancy to determine the status of reporting on financial statements prepared in accordance with IFRS for SMEs within their individual state. Any remaining barriers may come in the form of unwillingness by a private company’s financial statement users to accept financial statements prepared under IFRS for SMEs, and a private company’s expenditure of money, time, and effort to convert to IFRS for SMEs.

Information about IFRS for SMEs and about the activities of the IASB can be found at www.ifrs.com. In addition, the AICPA and the IASCF jointly have developed a conference titled “IFRS in North America 2009: The U.S. Perspective” to be held October 29–30 in New York. IFRS for SMEs will be addressed at the conference. For more information about the conference, visit www.cpa2biz.com.

The AICPA Launches IFRS.com Web Site

To assist in both awareness building and education, the AICPA launched the new Web site, www.ifrs.com, in May 2008. The site provides current information about developments in international convergence. Developed by the AICPA, in partnership with its marketing and technology subsidiary, CPA2Biz, www.ifrs.com provides a comprehensive set of resources for accounting professionals, auditors, financial managers, audit committees, and other users of financial statements.

The Web site features tools and resources to help CPAs get acquainted with IFRSs, the surrounding issues, and available support. Resources include a history of convergence, a high level overview of the differences between IFRSs and U.S. GAAP, frequently asked questions, articles, textbooks, continuing professional education (CPE) courses and live conference training, helpful links, and assistance for audit committee members.

Recent Pronouncements

AICPA auditing and attestation standards are applicable only to audits and attestation engagements of nonissuers. The PCAOB establishes auditing and attestation standards for audits of issuers. For information on pronouncements issued subsequent to the writing of this alert, please refer to the AICPA Web site at www.aicpa.org, the FASB Web site at www.fasb.org, and the PCAOB Web site at www.pcaob.org. You also may look for announcements of newly issued accounting standards in the CPA Letter and the Journal of Accountancy.

Recent Auditing and Attestation Pronouncements and Related Guidance

The following table presents a list of recently issued audit and attestation pronouncements and related guidance.
### Recent Auditing and Attestation Pronouncements and Related Guidance

<table>
<thead>
<tr>
<th>Pronouncement/Interpretation</th>
<th>Description</th>
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<tbody>
<tr>
<td><strong>Statement on Auditing Standards (SAS) No. 116, Interim Financial Information (AICPA, Professional Standards, vol. 1, AU sec. 722)</strong></td>
<td>This standard amends AU section 722 to accommodate reviews of interim financial information of nonissuers, including companies offering securities pursuant to Securities and Exchange Commission (SEC) Rule 144A or participating in private equity exchanges. It is effective for reviews of interim financial information for interim periods beginning after December 15, 2009. Earlier application is permitted.</td>
</tr>
<tr>
<td><strong>SAS No. 115, Communicating Internal Control Related Matters Identified in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325)</strong></td>
<td>Replacing SAS No. 112, Communicating Internal Control Related Matters Identified in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325A), this standard defines the terms deficiency in internal control, significant deficiency, and material weakness; provides guidance on evaluating the severity of deficiencies in internal control identified in an audit of financial statements; and requires the auditor to communicate in writing, to management and those charged with governance, significant deficiencies and material weaknesses identified in an audit. It is effective for audits of financial statements for periods ending on or after December 15, 2009. Earlier implementation is permitted.</td>
</tr>
<tr>
<td><strong>Statement on Standards for Attestation Engagements (SSAE) No. 15, An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements (AICPA, Professional Standards, vol. 1, AT sec. 501)</strong></td>
<td>This statement establishes requirements and provides guidance that applies when a practitioner is engaged to perform an examination of the design and operating effectiveness of an entity's internal control over financial reporting (examination of internal control) that is integrated with an audit of financial statements (integrated audit). This SSAE is effective for integrated audits for periods ending on or after December 15, 2008. Earlier implementation is permitted.</td>
</tr>
</tbody>
</table>
### Recent Auditing and Attestation Pronouncements and Related Guidance

**Standards, vol. 1, AU sec. 9330 par. .01–.08**  
Issue Date: April 2007  
Revised Date: November 2008  
(Interpretive publication)

This interpretation of AT section 101 addresses how a practitioner may report on the suitability of the design of an entity's internal control over financial reporting for preventing or detecting and correcting material misstatements of the entity's financial statements on a timely basis.

**Technical Questions and Answers (TIS) section 8700.01, "Effect of FASB ASC 855 on Accounting Guidance in AU Section 560" (AICPA, Technical Practice Aids)**  
Issue Date: September 2009  
(Nonauthoritative)

This question and answer addresses whether the accounting guidance in AU section 560, *Subsequent Events* (AICPA, Professional Standards, vol. 1) is effected by the issuance of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 855, *Subsequent Events*.

**TIS section 8700.02, "Auditor Responsibilities for Subsequent Events" (AICPA, Technical Practice Aids)**  
Issue Date: September 2009  
(Nonauthoritative)

This question and answer discusses whether the auditor's responsibilities under AU section 560 are changed as a result of the issuance of FASB ASC 855.

**TIS section 1500.07, "Disclosure Concerning Subsequent Events in OCBOA Financial Statements" (AICPA, Technical Practice Aids)**  
Issue Date: July 2009  
(Nonauthoritative)

This question and answer addresses whether full disclosure financial statements prepared on an other comprehensive basis of accounting should contain the disclosures set forth in FASB ASC 855.

(continued)
### Recent Auditing and Attestation Pronouncements and Related Guidance

<table>
<thead>
<tr>
<th>TIS section</th>
<th>Question and Answer</th>
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<tr>
<td>1900.01</td>
<td>This question and answer indicates that when preparing condensed interim financial statements, nonissuers may analogize to the guidance in Article 10 of SEC Regulation S-X regarding form and content because Accounting Principles Board (APB) Opinion No. 28, <em>Interim Financial Reporting</em>, does not provide a reporting framework. APB Opinion No. 28 is codified primarily at FASB ASC 270, <em>Interim Reporting</em>.</td>
</tr>
<tr>
<td>9150.25</td>
<td>This question and answer discusses what an accountant should consider in determining whether he or she has prepared the financial statements of a nonissuer.</td>
</tr>
<tr>
<td>1100.15</td>
<td>This question and answer discusses auditing and accounting issues related to withdrawal restrictions placed on short term investments by a money market fund or its trustee.</td>
</tr>
</tbody>
</table>
| 8200.05–.16 | These questions and answers in TIS section 8200, *Internal Control*, were developed in response to common questions received from members regarding the implementation of SAS Nos. 104–111. Some of the topics include the following:  
- Consideration of internal controls that are less formal or not documented by the client  
- Whether the auditor may suggest improvements to a client's internal control.  
- Assessing inherent risk in relation to the consideration of control risk  
- Frequency of walkthroughs that are used as the basis for the auditor's understanding of internal control  
- Considerations in obtaining an understanding of, evaluating, and documenting controls that the auditor believes are nonexistent or ineffective  
- Assessing control risk at the maximum level  
- Considerations for developing a substantive audit strategy |

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### Recent Auditing and Attestation Pronouncements and Related Guidance

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<tr>
<th>TIS section 9120.08, “Part of an Audit Performed in Accordance With International Standards on Auditing” (AICPA, Technical Practice Aids)</th>
<th>This question and answer discusses the implications to the principal auditor's report when part of an audit is conducted by other independent auditors, in accordance with International Standards on Auditing or another country's auditing standards.</th>
</tr>
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<tbody>
<tr>
<td>Issue Date: April 2008 (Nonauthoritative)</td>
<td></td>
</tr>
<tr>
<td>**Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 6, Evaluating Consistency of Financial Statements (AICPA, PCAOB Standards and Related Rules, Auditing Standards)</td>
<td>This standard and its related amendments update the auditor's responsibilities to evaluate and report on the consistency of a company's financial statements and align the auditor's responsibilities with FASB Statement No. 154, Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3, which is codified in FASB ASC 250, Accounting Changes and Error Corrections. This standard also improves the auditor reporting requirements by clarifying that the auditor's report should indicate whether an adjustment to previously issued financial statements results from a change in accounting principles or the correction of a misstatement. It is effective November 15, 2008.</td>
</tr>
<tr>
<td>Issue Date: September 2008 (Applicable to audits conducted in accordance with PCAOB standards)</td>
<td></td>
</tr>
<tr>
<td>**PCAOB Rule 3526, Communication with Audit Committees Concerning Independence (AICPA, PCAOB Standards and Related Rules, Select Rules of the Board)</td>
<td>Rule 3526 requires the registered public accounting firm to</td>
</tr>
<tr>
<td>Issue Date: August 2008 (Applicable to audits conducted in accordance with PCAOB standards)</td>
<td>- describe in writing, to the audit committee of the issuer, all relationships between the registered public accounting firm or any affiliates of the firm and the potential audit client or persons in financial reporting oversight roles at the potential audit client that, as of the date of the communication, may reasonably be thought to bear on independence.</td>
</tr>
<tr>
<td></td>
<td>- discuss with the audit committee of the issuer the potential effects of any relationships that could affect independence, should they be appointed as the issuer's auditor.</td>
</tr>
<tr>
<td></td>
<td>- document the substance of these discussions. These discussions should occur at least annually.</td>
</tr>
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(continued)
## Audit Risk Alert

### Recent Auditing and Attestation Pronouncements and Related Guidance

The board also adjusted the implementation schedule for Rule 3523, *Tax Services for Persons in Financial Reporting Oversight Roles* (AICPA, *PCAOB Standards and Related Rules*, Select Rules of the Board), as it applies to tax services. The board agreed not to apply Rule 3523 to tax services provided on or before December 31, 2008, when those services are provided during the audit period and are completed before the professional engagement period begins. The amendments to Rule 3523 became effective August 28, 2008. The remaining provisions of Rule 3526 became effective on September 30, 2008.


**PCAOB Staff Audit Practice Alert No. 4, Auditor Considerations Regarding Fair Value Measurements, Disclosures, and Other-Than-Temporary Impairments (AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 400.04)**

This staff audit practice alert is designed to inform auditors about potential implications of the FASB Staff Positions on reviews of interim financial information and annual audits. This alert addresses the following topics:

- Reviews of interim financial information
- Audits of financial statements, including integrated audits
- Disclosures
- Auditor reporting considerations

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Recent Auditing and Attestation Pronouncements and Related Guidance

This practice alert is designed to assist auditors in identifying matters related to the current economic environment that might affect audit risk and require additional emphasis. The practice alert addresses the following six main areas: overall audit considerations, auditing fair value measurements, auditing accounting estimates, auditing the adequacy of disclosures, auditor’s consideration of a company’s ability to continue as a going concern, and additional audit considerations for selected financial reporting areas.

Recent Accounting Pronouncements and Related Guidance

The following table presents a list of recently issued accounting pronouncements and related guidance.

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<tbody>
<tr>
<td>FASB ASC ASU No. 2009-13 (October 2009)</td>
<td>Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force</td>
</tr>
<tr>
<td>FASB ASC ASU No. 2009-12 (September 2009)</td>
<td>Fair Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)</td>
</tr>
<tr>
<td>FASB ASC ASU No. 2009-1 (September 2009)</td>
<td>Income Taxes (Topic 740)—Extractive Activities—Oil and Gas—Amendment to Section 932-10-S99</td>
</tr>
<tr>
<td>FASB ASC ASU No. 2009-10 (September 2009)</td>
<td>Financial Services—Broker and Dealers: Investments—Other—Amendment to Subtopic 940-325</td>
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## Recent Accounting Pronouncements and Related Guidance

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<tr>
<td>September 2009</td>
<td><strong>FASB ASC ASU No. 2009-09</strong>&lt;br&gt;Accounting for Investments—Equity Method and Joint Ventures and Accounting for Equity-Based Payments to Non-Employees—Amendments to Sections 323-10-S99 and 505-50-S99</td>
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<tr>
<td>September 2009</td>
<td><strong>FASB ASC ASU No. 2009-08</strong>&lt;br&gt;Earnings per Share—Amendments to Section 260-10-S99</td>
</tr>
<tr>
<td>September 2009</td>
<td><strong>FASB ASC ASU No. 2009-07</strong>&lt;br&gt;Accounting for Various Topics—Technical Corrections to SEC Paragraphs</td>
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<tr>
<td>September 2009</td>
<td><strong>FASB ASC ASU No. 2009-06</strong>&lt;br&gt;Income Taxes (Topic 740)—Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities</td>
</tr>
<tr>
<td>August 2009</td>
<td><strong>FASB ASC ASU No. 2009-05</strong>&lt;br&gt;Fair Value Measurements and Disclosures (Topic 820)—Measuring Liabilities at Fair Value</td>
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<td>August 2009</td>
<td><strong>FASB ASC ASU No. 2009-04</strong>&lt;br&gt;Accounting for Redeemable Equity Instruments—Amendment to Section 480-10-S99</td>
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<tr>
<td>August 2009</td>
<td><strong>FASB ASC ASU No. 2009-03</strong>&lt;br&gt;SEC Update—Amendments to Various Topics Containing SEC Staff Accounting Bulletins</td>
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<tr>
<td>June 2009</td>
<td><strong>FASB ASC ASU No. 2009-02</strong>&lt;br&gt;Omnibus Update—Amendments to Various Topics for Technical Corrections</td>
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<td>June 2009</td>
<td><strong>FASB ASC ASU No. 2009-01</strong>&lt;br&gt;Topic 105—Generally Accepted Accounting Principles—amendments based on—Statement of Financial Accounting Standards No. 168—The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles</td>
</tr>
<tr>
<td>June 2009</td>
<td><strong>FASB Statement No. 168</strong>&lt;br&gt;(Codified in FASB ASC 105, Generally Accepted Accounting Principles)&lt;br&gt;The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162</td>
</tr>
<tr>
<td>June 2008</td>
<td><strong>FASB Statement No. 167</strong>&lt;br&gt;Amendments to FASB Interpretation No. 46(R)</td>
</tr>
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10 See footnote 8.
Insurance Industry Developments—2009

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<th>Recent Accounting Pronouncements and Related Guidance</th>
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<td><strong>FASB Statement No. 166</strong>&lt;sup&gt;11&lt;/sup&gt; (June 2009)</td>
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<tr>
<td><strong>FASB Statement No. 165</strong> (May 2009)</td>
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<td>(Codified in FASB ASC 855, Subsequent Events)</td>
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<td><strong>FASB Statement No. 164</strong>&lt;sup&gt;12&lt;/sup&gt; (April 2009)</td>
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<td><strong>FASB Statement No. 163</strong> (May 2008)</td>
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<td>(Codified in FASB ASC 944, Financial Services—Insurance)</td>
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<tr>
<td><strong>FASB Statement No. 162</strong> (May 2008)</td>
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<tr>
<td>(Superseded by FASB Statement No. 168 in June 2009)</td>
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<tr>
<td><strong>FASB Staff Positions (FSPs)</strong> (Various dates)</td>
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<tr>
<td><strong>Technical Questions and Answers (TIS)</strong> section 6910.30, &quot;Disclosure Requirements of Investments for Nonregistered Investment Partnerships When Their Interest in an Investee Fund Constitutes Less Than 5 Percent of the Nonregistered Investment Partnership’s Net Assets&quot; (AICPA, Technical Practice Aids)</td>
</tr>
<tr>
<td>Issue Date: August 2009 (Nonauthoritative)</td>
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<tr>
<td><strong>TIS section 6910.31, &quot;The Nonregistered Investment Partnership’s Method for Calculating Its Proportional Share of Any Investments Owned by an</strong></td>
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<sup>11</sup> See footnote 8.<br><sup>12</sup> See footnote 8.
### Recent Accounting Pronouncements and Related Guidance

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<tr>
<th>Description</th>
<th>Issue Date</th>
<th>Authoritative Status</th>
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<tbody>
<tr>
<td>Investee Fund in Applying the '5 Percent Test' Described in TIS Section 6910.30&quot; (AICPA, Technical Practice Aids)</td>
<td>August 2009</td>
<td>Nonauthoritative</td>
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<tr>
<td>TIS section 6910.32, &quot;Additional Financial Statement Disclosures for Nonregistered Investment Partnerships When the Partnership Has Provided Guarantees Related to the Investee Fund's Debt&quot; (AICPA, Technical Practice Aids)</td>
<td>August 2009</td>
<td>Nonauthoritative</td>
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<tr>
<td>TIS section 1600.04, &quot;Presentation of Assets at Current Values and Liabilities at Current Amounts in Personal Financial Statements&quot; (AICPA, Technical Practice Aids)</td>
<td>June 2009</td>
<td>Nonauthoritative</td>
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<tr>
<td>TIS section 6931.11, &quot;Fair Value Measurement Disclosures for Master Trusts&quot; (AICPA, Technical Practice Aids)</td>
<td>March 2009</td>
<td>Nonauthoritative</td>
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<tr>
<td>TIS section 6995.02, &quot;Evaluation of Capital Investments in Corporate Credit Unions for Other-Than-Temporary Impairment&quot; (AICPA, Technical Practice Aids)</td>
<td>February 2009</td>
<td>Nonauthoritative</td>
</tr>
<tr>
<td>TIS section 6995.01, &quot;Financial Reporting Issues Related to Actions Taken by the National Credit Union Administration on January 28, 2009 in Connection With the Corporate Credit Union System and the National Credit Union Share Insurance Fund&quot; (AICPA, Technical Practice Aids)</td>
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### Recent Accounting Pronouncements and Related Guidance

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<tr>
<th>Issue Date: January 2009 (Nonauthoritative)</th>
<th>December 31, 2008. Additionally, this question and answer presents alternative views on when and how the obligation for the insurance premium should be recognized for financial reporting purposes.</th>
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<tr>
<td>TIS section 6910.29, &quot;Allocation of Unrealized Gain (Loss), Recognition of Carried Interest, and Clawback Obligations&quot; (AICPA, Technical Practice Aids)</td>
<td>This question and answer discusses how cumulative unrealized gains (losses), carried interest, and clawback should be reflected in the equity balances of each class of shareholder or partner at the balance sheet date when preparing financial statements of an investment partnership, in accordance with U.S. generally accepted accounting principles, in which capital is reported by investor class. In particular, this question and answer asks if cumulative period-end unrealized gains and losses should be allocated as if realized in accordance with the partnership’s governing documents prior to the date, time, or event specified in the partnership agreement.</td>
</tr>
<tr>
<td>TIS section 1900.01, &quot;Condensed Interim Financial Reporting by Nonissuers&quot; (AICPA, Technical Practice Aids)</td>
<td>This question and answer indicates that when preparing condensed interim financial statements, nonissuers may analogize to the guidance in Article 10 of SEC Regulation S-X regarding form and content because Accounting Principles Board (APB) Opinion No. 28, <em>Interim Financial Reporting</em>, does not provide a reporting framework. APB Opinion No. 28 is codified primarily at FASB ASC 270, <em>Interim Reporting</em>.</td>
</tr>
<tr>
<td>TIS section 6300.36, &quot;Prospective Unlocking&quot; (AICPA, Technical Practice Aids)</td>
<td>This question and answer discusses when an insurance company may change its original policyholder benefit liability assumptions.</td>
</tr>
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Recent Accounting Pronouncements and Related Guidance

TIS section 1100.15, "Liquidity Restrictions" (AICPA, Technical Practice Aids)
Issue Date: October 2008 (Nonauthoritative)

This question and answer discusses auditing and accounting issues related to withdrawal restrictions placed on short term investments by a money market fund or its trustee.

Recent AICPA Independence and Ethics Pronouncements

.199 Audit Risk Alert Independence and Ethics Developments—2009 (product no. 0224709) contains a complete update on new independence and ethics pronouncements. This alert will heighten your awareness of independence and ethics matters likely to affect your practice. Obtain this alert by calling the AICPA at (888) 777-7077 or visiting www.cpa2biz.com.

On the Horizon

.200 Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements. The following sections present brief information about some ongoing projects that have particular significance to the insurance industry or that may result in significant changes. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing existing standards.

.201 The following table lists the various standard setting bodies’ Web sites, through which information may be obtained on outstanding exposure drafts, including downloading exposure drafts. These Web sites contain in-depth information about proposed standards and other projects in the pipeline. Many more accounting and auditing projects exist in addition to those discussed here. Readers should refer to information provided by the various standard setting bodies for further information.

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<th>Standard Setting Body</th>
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<tr>
<td>AICPA Auditing Standards Board</td>
<td><a href="http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/">www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/</a></td>
</tr>
<tr>
<td>Financial Accounting Standards Board</td>
<td><a href="http://www.fasb.org">www.fasb.org</a></td>
</tr>
<tr>
<td>Governmental Accounting Standards Board</td>
<td><a href="http://www.gasb.org">www.gasb.org</a></td>
</tr>
<tr>
<td>Professional Ethics Executive Committee</td>
<td><a href="http://www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/">www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/</a></td>
</tr>
<tr>
<td>Public Company Accounting Oversight Board</td>
<td><a href="http://www.pcaob.org">www.pcaob.org</a></td>
</tr>
<tr>
<td>Securities and Exchange Commission</td>
<td><a href="http://www.sec.gov">www.sec.gov</a></td>
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Insurance Industry Developments—2009

Overhaul Project—AICPA Audit and Accounting Guide Property and Liability Insurance Entities

.202 The AICPA is continuing to make progress overhauling the AICPA Audit and Accounting Guide Property and Liability Insurance Entities, addressing numerous accounting, auditing, industry, and regulatory issues that have transpired since this guide was originally issued in 1990. During this project, the AICPA will continue to issue annual editions of the guide, updated to reflect recent audit and accounting pronouncements.

Auditing and Attestation Pipeline—Nonissuers

Auditing Standards Board Clarity Project

.203 In response to growing concerns about the complexity of standards, the ASB has commenced a large-scale clarity project to revise all existing auditing standards so they are easier to read and understand. Over the next two or three years, the ASB will be redrafting all of the existing auditing sections contained in the Codification of Statements on Auditing Standards (AU sections of the AICPA’s Professional Standards) to apply the clarity drafting conventions and converge with the International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB). The ASB proposes that, except to address current issues, all redrafted standards will become effective at the same time. Only those standards needing to address current issues would have earlier effective dates. The ASB believes that a single effective date will ease the transition to, and implementation of, the redrafted standards. The effective date will be long enough after all redrafted statements are finalized to allow sufficient time for training and updating of firm audit methodologies. Currently, the date is expected to be for audits of financial statements for periods beginning no earlier than December 15, 2010. This date depends on satisfactory progress being made and will be amended, should that prove necessary. See the explanatory memorandum “Clarification and Convergence” and the discussion paper Improving the Clarity of ASB Standards at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Improving+the+Clarity+of+ASB+Standards.htm.

Exposure Draft to Revise Standards for Compilation and Review Engagements

.204 The Accounting and Review Services Committee (ARSC) issued an exposure draft that would revise the standards for compilation and review engagements. The changes would affect the interplay between the standards and independence rules, permitting an accountant to issue a review report on financial statements when the accountant’s independence is impaired by performing certain nonattest services (described in the exposure draft as internal control services) that were designed to improve the reliability of the client’s financial information.

.205 The exposure draft includes a trio of proposed standards: Framework and Objectives for Performing and Reporting on Compilation and Review Engagements, Compilation of Financial Statements, and Review of Financial Statements. In drafting the proposed standards, the ARSC considered recommendations from the Private Company Practice Section (PCPS) Reliability Task Force. The ARSC and PCPS believe the proposed standards will respond to
many concerns of smaller business owners, users of small business financial statements, and CPAs who serve smaller entities.

.206 The PCPS task force recommended that the ARSC consider revising its standards for situations in which an accountant's independence is impaired in connection with the performance of a nonattest service relating to the design or operation of an aspect of internal control over financial reporting. These nonattest services help management prepare higher quality or more reliable financial statements.

.207 The proposed standards also would harmonize the AICPA's review standard with the IAASB's review standard, International Standard on Review Engagements No. 2400, Engagements to Review Financial Statements.

.208 Significant proposed changes to the Statements on Standards for Accounting and Review Services include the following:

- The introduction of new terms, such as moderate assurance, review evidence, and review risk, to the review literature to harmonize with international review standards.
- A discussion of materiality in the context of a review engagement.
- A requirement that an accountant establish an understanding with management regarding the services to be performed through a written communication (that is, an engagement letter).
- The establishment of enhanced documentation requirements for compilation and review engagements.
- Guidance for practitioners who are engaged to perform a compilation or review engagement when they also have been engaged to perform nonattest services. The guidance includes reporting requirements for instances in which the accountant's independence is impaired due to the performance of these services.
- The ability for an accountant to include a general description in the accountant's compilation report regarding the reason(s) for an independence impairment.

.209 The comment deadline is July 31, 2009. The proposed effective date is for compilations and reviews of financial statements for periods beginning on or after December 15, 2010. Early application would be permitted. For further information on this project, visit www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/ARSC+Reliability+Project.htm.

**Exposure Drafts on Service Organizations**

.210 The ASB issued an exposure draft (using clarity drafting conventions) that would supersede AU section 324, Service Organizations (AICPA, Professional Standards, vol. 1), which contains guidance for auditors auditing the financial statements of entities that use a service organization (user auditors) and for auditors reporting on controls at a service organization (service auditors). The proposed SAS only contains guidance for user auditors and is based on the December 2007 exposure draft of International Standard on Auditing (ISA) 402 (Revised and Redrafted), Audit Considerations Relating to an Entity Using a Third Party Service Organization. Guidance for service auditors will be contained in a new Statement on Standards for Attestation Engagements (SSAE), Reporting on Controls at a Service Organization, which was exposed
for comment concurrently with this proposed SAS. AU section 324 would retain this new user auditor guidance and be renamed Audit Considerations Relating to an Entity Using a Service Organization. The key provisions of the proposed SAS are as follows:

- In a type 2 report, the service auditor’s report would contain an opinion on the fairness of the description of the service organization’s system and the suitability of the design of the controls for a period (rather than as of a specified date).
- A user auditor would be permitted to make reference to the work of a service auditor in his or her report to explain a modification of the user auditor’s opinion. In those circumstances, the user auditor’s report must indicate that such reference does not diminish the user auditor’s responsibility for that opinion.
- A user auditor would be required to inquire of management of the user entity about whether the service organization has reported to the user entity any fraud, noncompliance with laws and regulations, or uncorrected misstatements. If so, the user auditor would be required to evaluate how such matters affect the nature, timing, and extent of the user auditor’s further audit procedures.
- The proposed SAS also would be applicable to situations in which an entity uses a shared service organization that provides services to a group of related entities.

The proposed SSAE would supersede the requirements and guidance in AU section 324 for auditors reporting on controls at service organizations. It is based on the December 2007 exposure draft of International Standard on Assurance Engagements 3402, Assurance Reports on Controls at a Third Party Service Organization. The proposed SSAE has six provisions:

- First, as a condition of engagement performance, management of the service organization would be required to provide the service auditor with certain written assertions related to their system and design of controls.
- Second, a service auditor would be able to report on controls at a service organization other than controls that are relevant to user entities’ financial reporting (such as controls related to regulatory compliance).
- The third key provision mirrors the provision of the proposed SAS which discusses the service auditor’s opinion in a type 2 report.
- Fourth, when obtaining an understanding of the service organization’s system, the service auditor would be required to obtain information to identify risks that the description of the service organization’s system is not fairly presented or that the control objectives stated in the description were not achieved due to intentional acts by service organization personnel.
- Next, when assessing the operating effectiveness of controls in a type 2 engagement, evidence obtained in prior engagements about the satisfactory operation of controls in prior periods does not provide a basis for a reduction in testing, even if supplemented with evidence obtained during the current period.
Lastly, the proposed SSAE specifies the wording to be used in a service auditor's type 1 or 2 report to describe the customers to whom use of the report is restricted.

The exposure draft indicates that the proposed SAS would be effective for audits of financial statements for periods beginning on or after December 15, 2010. This is a provisional effective date; however the actual effective date will not be any earlier. The ASB requested feedback on the effective date of the proposed SSAE. The comment period for both ended on February 17, 2009. The exposure drafts, a disposition of AU section 324 in the proposed SSAE, and a disposition of AU section 324 in the proposed SAS can all be accessed at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Exposure+Drafts+of+Proposed+Statements/. Constituents should be alert for developments.

**Exposure Draft on Auditing Accounting Estimates**

The ASB recently issued an exposure draft with clarity drafting conventions, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures (Redrafted)*, which would supersede AU sections 342 and 328. This proposed SAS is based on ISA 540, *Auditing Accounting Estimates, Including Fair Value Estimates and Related Disclosures*. This exposure draft does not significantly change or expand the guidance in AU sections 342 or 328; however it does combine the two sections.

Comments on the proposed SAS were due on November 30, 2009. The ASB was specifically seeking comments on changes resulting from applying the clarity conventions and converging with the ISA. This proposed SAS would be effective for audits of financial statements for periods beginning on or after December 15, 2010. This effective date is provisional, but will not be any earlier. The proposed SAS can be accessed at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Exposure+Drafts+of+Proposed+Statements/Proposed+Statement+on+Auditing+Standards+Estimates.htm.

**Implementation Guidance for Compilation and Review Standards**

The AICPA is working on two products to further your knowledge of the new compilation and review standards. The first product is the AICPA's annual alert *Compilation and Review Engagements—2009*. This alert provides an annual update on issues affecting compilation and review engagements and will focus on the proposed new standards, among other issues, affecting practitioners performing compilation and review engagements. This alert is scheduled to be released in December 2009, just in time for your 2009 compilation and review engagement planning. The second product is a brand new AICPA Guide, *Compilation and Review Engagements*, which will provide additional information on implementing the new compilation and review standards and understanding internal control services. It also will include illustrative letters, sample reports, and case studies. This guide is expected to be available in 2010. See www.cpa2biz.com for further information.

**Auditing and Attestation Pipeline—Issuers**

**PCAOB Risk Assessment Standards**

In October 2008, the PCAOB proposed seven new auditing standards to update and supersede the current risk assessment standards. The PCAOB
chairman noted that the proposals demonstrate the view that the risk of fraud is a central part of the audit process and not a separate consideration. The proposed standards integrate the risk assessment standards with the standard for the audit of internal control over financial reporting. Many of the IAASB's risk assessment standards were utilized in creating these proposed standards, and efforts were made to reduce any unnecessary differences. Each of these proposed standards has a statement of objective for the auditor, which was loosely adapted from the ISAs. This is an example of the move in the United States from rules-based to principles-based accounting and auditing standards because these objectives do not state required outcomes. The seven proposed standards are as follows:

- Audit Risk in an Audit of Financial Statements
- Audit Planning and Supervision
- Identifying and Assessing Risks of Material Misstatement
- The Auditor's Responses to the Risks of Material Misstatement
- Evaluating Audit Results
- Consideration of Materiality in Planning and Performing an Audit
- Audit Evidence

In February 2009, the CAQ issued a comment letter on the proposed standards. Readers can review the full text of the comment letter at http://thecaq.org/newsroom/pdfs/CAQCommentLetter-PCAOBRiskAssessmentAuditStds.pdf. The comment period for these proposed standards ended in February 2009. As with any new auditing standard or amendment to a PCAOB standard, after adoption by the PCAOB, the standards will be submitted to the SEC for approval.

**Engagement Quality Review**

In March 2009, the PCAOB reproposed an auditing standard on engagement quality review for public comment. The PCAOB made substantial changes to the proposed auditing standard because it was first proposed in February 2008. The proposal would supersede the PCAOB’s current audit quality control standard and would apply to all audit engagements and engagements to review interim financial information conducted pursuant to the standards of the PCAOB. The proposed standard provides a framework for an engagement quality reviewer to objectively evaluate the significant judgments made by the engagement team and the conclusions reached in forming an overall conclusion about the engagement. In July 2009, the PCAOB voted to adopt this standard as Auditing Standard No. 7, *Engagement Quality Review*. This standard will be effective, subject to SEC approval, for both engagement quality reviews of audits and interim reviews for fiscal years beginning on or after December 15, 2009.

**Concept Release on Audit Confirmations**

In April 2009, the PCAOB issued a concept release for public comment on possible revisions to AU section 330, *The Confirmation Process* (AICPA, PCAOB Standards and Related Rules, Interim Standards). Confirmations are typically an important source of evidence for auditors as independent third party sources verify the data on the confirmation. The PCAOB’s concept release
addresses the following 9 areas of possible change to the current confirmation guidance:

- Expands the definition of confirmation to include direct access to information held by a third party
- Establishes a presumption that the auditor will request the confirmation of accounts receivable
- Discusses factors to consider in designing confirmation requests
- Updates the requirement for maintaining control over confirmation requests for the advances in technology
- Provides further direction on evaluating the reliability of confirmation responses
- Eliminates the ability for the auditor to omit performing alternative procedures for nonresponses to positive confirmation requests
- Considerations for when management requests an auditor to not confirm a select account, transaction, and so on
- Conducts an evaluation of disclaimers and restrictive language on confirmation responses
- Considers whether the use of negative confirmations should continue to be allowed

Generally speaking, the concept release does not contemplate major changes to the confirmation process; rather it addresses developments in technology and related risk factors. Comments were due back to the PCAOB by the end of May 2009. Readers should be alert to developments on this issue.

**Accounting Pipeline**

**FASB and IASB Memorandum of Understanding**

In September 2008, FASB and the IASB updated their "Memorandum of Understanding" (MoU), originally published in 2006, to reaffirm their respective commitments to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. In developing the original MoU, FASB and the IASB agreed on priorities and established milestones as part of a joint work program to develop new common standards that improve the financial information reported to investors. FASB and the IASB agreed that the goal of joint projects is to produce common, principles-based standards, subject to the required due process. In the MoU, the boards identified the following 11 convergence topics on which to focus:

- Business combinations
- Financial instruments
- Financial statement presentation
- Intangible assets
- Leases
- Liabilities and equity distinctions
- Revenue recognition
- Consolidations
- Derecognition
Insurance Industry Developments—2009

- Fair value measurement
- Postemployment benefits (including pensions)

Both FASB and the IASB note that their individual and joint efforts are not limited to the preceding items, but they remain committed to the MoU. FASB and the IASB also have several other joint projects in process, including the conceptual framework project, emissions trading schemes, insurance contracts (see additional discussion in the "IASB and FASB Insurance Contracts Project" section of this alert), and income taxes.

Readers also are encouraged to monitor developments on the AICPA's Web site, www.ifrs.com, in addition to the FASB, IASB, and SEC Web sites. The growing acceptance of IFRSs as a basis for U.S. financial reporting could represent a fundamental change for the U.S. accounting profession.

Other Accounting Projects

Additionally, FASB has the following projects underway:

- Going concern
- Credit crisis projects that include the following:
  - Measuring liabilities under FASB ASC 820
  - Embedded credit derivatives scope exceptions
  - Recoveries of other-than-temporary impairments
  - Improving disclosures about fair value measurements
- Disclosure of certain loss contingencies
- Loan loss disclosures
- Disclosure framework
- Phase 2 of postretirement benefit obligations, including pensions
- Oil and gas disclosures
- Treatment of base jackpot liabilities of casinos

FASB and the IASB established an advisory group, the Financial Crisis Advisory Group (FCAG), which is composed of senior leaders with international experience in financial markets. The FCAG will advise FASB and the IASB about the standard setting implications of the global financial crisis as well as changes to the global regulatory environment. Readers should refer to http://fasb.org/fcag/index.shtml for additional information.

IASB and FASB Insurance Contracts Project

The IASB continues to work on phase II of the insurance contracts project, which will provide a basis for consistent accounting for insurance contracts on the longer term. In October 2008, FASB decided to participate in this project, so it is now a joint project. However, the project is not part of the MoU with FASB. The IASB is reviewing the comments received on the discussion paper, Preliminary Views on Insurance Contracts, published in May 2007, and is working towards an exposure draft that it aims to publish in late 2009 with a final standard to be issued in 2011. At their June 2009 meeting, the insurance working group provided input for a number of issues resulting from the board meetings, from responses to the discussion paper, and from the previous working group meeting in November 2008. In July 2009, the IASB and FASB held a joint meeting where the boards were briefed on each other's latest views
Audit Risk Alert regarding a preferred measurement approach for insurance liabilities and the treatment of acquisition costs. The next joint meeting of the boards is scheduled to be held in October 2009. A summary of decisions reached to date can be found on the FASB Web site at www.fasb.org/insurance_contracts.shtml.

Resource Central

The following are various resources that practitioners engaged in the insurance industry may find beneficial.

Publications

Practitioners may find the following publications useful. Choose the format best for you—online, print, or CD-ROM.

- Audit and Accounting Guide Life and Health Insurance Entities (2009) (product no. 012639 [paperback], WLH-XX [online], or DLH-XX [CD-ROM])
- Audit and Accounting Guide Property and Casualty Insurance Entities (2009) (product no. 012679 [paperback], WPL-XX [online], or DPL-XX [CD-ROM])
- Audit Guide Analytical Procedures (2008) (product no. 012558 [paperback], WAN-XX [online], or DAN-XX [CD-ROM])
- Audit Guide Auditing Revenue in Certain Industries (2009) (product no. 012519 [paperback], WAR-XX [online], or DAR-XX [CD-ROM])
- Audit Guide Audit Sampling (2008) (product no. 012538 [paperback], WAS-XX [online], or DAS-XX [CD-ROM])
- Audit Guide Service Organizations: Applying SAS No. 70, as Amended (2009) (product no. 012779 [paperback], WSV-XX [online], or DSV-XX [CD-ROM])
- Audit Risk Alert Compilation and Review Developments—2008 (product no. 022309 [paperback], WCR-XX [online], or DCR-XX [CD-ROM])
- Audit Risk Alert Current Economic Instability: Accounting and Auditing Considerations—2009 (product no. 0223309 [paperback], WGE-XX [online], or DGE-XX [CD-ROM])
- Audit Risk Alert Independence and Ethics Developments—2009 (product no. 0224709 [paperback], WIA-XX [online], or DIA-XX [CD-ROM])
- Checklists and Illustrative Financial Statements Life and Health Insurance Entities (product no. 008959 [paperback] or WLI-CL [online])
- Checklists and Illustrative Financial Statements Property and Casualty Insurance Entities (product no. 008969 [paperback] or WPI-CL [online])
- Accounting Trends & Techniques, 62nd Edition (product no. 009900 [paperback] or WAT-XX [online])
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- Audit and Accounting Manual (2009) (product no. 0051309 [paperback], WAM-XX [online], or AAM-XX [loose leaf])
- Audit and Accounting Practice Aid Independence Compliance: Checklists and Tools for Complying With AICPA and GAO Independence Requirements (product no. 006661 [paperback])
- Audit and Accounting Practice Aid Independence Compliance: Checklists and Tools for Complying With AICPA, SEC, and PCAOB Independence Requirements (product no. 006660 [paperback])

Additional resources for accountants in business and industry are the Financial Reporting Alert series, designed to be used by members of an entity's financial management and audit committee to identify and understand current accounting and regulatory developments affecting the entity's financial reporting.

- Financial Reporting Alert Not-for-Profit Organizations: Accounting Issues and Risks—2009 (product no. 0292209 [paperback])

AICPA reSOURCE: Accounting and Auditing Literature

The AICPA has created your core accounting and auditing library online. AICPA reSOURCE is now customizable to suit your preferences or your firm's needs. Or, you can sign up for access to the entire library. Get access—anytime, anywhere—to the FASB ASC, AICPA’s latest Professional Standards, Technical Practice Aids, Audit and Accounting Guides, Audit Risk Alerts, Accounting Trends & Techniques, and more. To subscribe to this essential online service for accounting professionals, visit www.cpa2biz.com.

AICPA Accounting Guidance Library

AICPA reSOURCE Online now offers FASB ASC. As discussed previously in this alert, FASB ASC significantly changes the structure and hierarchy of accounting and reporting standards into a topically organized format.

In this extraordinary member value, the AICPA is offering online access to FASB ASC along with our most popular Audit and Accounting Guides for only $659 for a one year subscription (product number WGC-XX).

This new library gives you online access to FASB ASC and the following AICPA Audit and Accounting Guides:

- Construction Contractors
- Depository and Lending Institutions
- Employee Benefit Plans
- Investment Companies
- Life and Health Insurance Entities
- Not-for-Profit Entities
- Property and Liability Insurance Entities

The guides have been fully conformed and linked to FASB ASC and will help ease your transition to the new structure. In addition, these guides
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provide a key entry point to understanding the impact of FASB ASC on your work.

While working in FASB ASC on AICPA reSOURCE Online, you will be able to do the following:

- Perform a full-text search.
- Browse by topic.
- Use quick go to navigation to find a specific FASB ASC reference.
- Access a cross reference report that identifies where legacy material is now located and link directly to that content.
- View the source of the codified content.
- Join sections and subsections.
- Access an archive function of previous versions of FASB ASC content.
- See all FASB ASC content that links to a given paragraph.

Subscribe today and make the transition to the new FASB ASC at a member-only value price of $659. Discounted multiuser subscriptions are available for this library. To order, call 888-777-7077 or go to www.cpa2biz.com.

CPE

The AICPA offers a number of CPE courses that are valuable to CPAs working in public practice and industry, including the following:

- **AICPA's Annual Accounting and Auditing Update Workshop (2009–2010 Edition)** (product no. 736185 [text] or 187193 [DVD]). Whether you are in industry or public practice, this course keeps you current and informed and shows you how to apply the most recent standards.
- **SEC Reporting** (product no. 736776 [text] or 186757 [DVD]). Confidently comply with the latest SEC reporting requirements with this comprehensive course. It clarifies new, difficult, and important reporting and disclosure requirements and gives you examples and tips for ensuring compliance.
- **International Versus U.S. Accounting: What in the World is the Difference?** (product no. 731667 [text]). Understanding the differences between IFRSs and U.S. GAAP is becoming more important for businesses of all sizes. This course outlines the major differences between IFRSs and U.S. GAAP.
- **The International Financial Reporting Standards: An Overview** (product no. 157220 [online] or 739750HS [CD-ROM]). This course captures a live presentation on IFRSs given to the AICPA board of directors.

Visit www.cpa2biz.com for a complete list of CPE courses.

Online CPE

AICPA CPExpress, offered exclusively through CPA2Biz, is the AICPA’s flagship online learning product. AICPA members pay $180 for a new
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subscription and $149 for the annual renewal. Nonmembers pay $435 for a new subscription and $375 for the annual renewal. Divided into 1-credit and 2-credit courses that are available 24 hours a day, 7 days a week, AICPA CPExpress offers hundreds of hours of learning in a wide variety of topics.

To register or learn more, visit www.cpa2biz.com.

Webcasts

Stay plugged in to what is happening and earn CPE credit right from your desktop. AICPA webcasts are high quality, two-hour CPE programs that bring you the latest topics from the profession’s leading experts. Broadcast live, they allow you to interact with the presenters and join in the discussion. If you cannot make the live event, each webcast is archived and available on CD-ROM.

CFO Quarterly Roundtable Series

The CFO Quarterly Roundtable Series, brought to you each calendar quarter via webcast, covers a broad array of “hot topics” that successful organizations employ and subjects that are important to the CFO’s personal success. From financial reporting, budgeting, and forecasting to asset management and operations, the roundtable helps CFOs, treasurers, controllers, and other financial executives excel in their demanding roles.

SEC Quarterly Update Series

The SEC Quarterly Update Webcast Series, brought to you each calendar quarter, showcases the profession’s leading experts on what is “hot” at the SEC. From corporate accounting reform legislation and new regulatory initiatives to accounting and reporting requirements and corporate finance activities, these hard-hitting sessions will keep you “plugged in” to what is important. A must for preparers in public companies and practitioners who have public company clients, this is the place to be when it comes to knowing about the areas of current interest at the SEC.

IFRS Quarterly Webcast Series

The IFRS Quarterly Webcast Series, brought to you each calendar quarter, is part of a multistep educational process to get practitioners, financial managers, and auditors up to speed on all aspects of IFRSs implementation. Over the course of the quarterly series, IFRSs will be covered in depth. International harmonization is quickly approaching, and this series will help both accountants and auditors stay abreast of the developments and changes they will need to implement.

Member Service Center

To order AICPA products, receive information about AICPA activities, and get help with your membership questions, call the AICPA Service Operations Center at (888) 777-7077.

Hotlines

Accounting and Auditing Technical Hotline

Do you have a complex technical question about GAAP, other comprehensive bases of accounting, or other technical matters? If so, use the AICPA’s Accounting and Auditing Technical Hotline. AICPA staff will research your
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question and call you back with the answer. The hotline is available from 9 a.m. to 8 p.m. EST on weekdays. You can reach the Technical Hotline at (877) 242-7212 or online at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+and+Auditing+Technical+Help/.

Ethics Hotline

In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. You can reach the Ethics Hotline at (888) 777-7077 or by e-mail at ethics@aicpa.org.

The CAQ

The CAQ, which is affiliated with the AICPA, was created to serve investors, public company auditors, and the markets. The CAQ's mission is to foster confidence in the audit process and aid investors and the capital markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty, and trust.

To accomplish this mission, the CAQ works to make public company audits even more reliable and relevant for investors in a time of growing financial complexity and market globalization. The CAQ also undertakes research, offers recommendations to enhance investor confidence and the vitality of the capital markets, issues technical support for public company auditing professionals, and helps facilitate the public discussion about modernizing business reporting. The CAQ is a voluntary membership center that provides education, communication, representation, and other means to member firms that audit or are interested in auditing public companies. To learn more about the CAQ, visit http://thecaq.aicpa.org.

AICPA Industry Expert Panel—Insurance

For information about the activities of the AICPA Insurance Industry Expert Panel, visit the panel’s Web page at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/expertpanel_insurance.htm.

Industry Web Sites

The Internet covers a vast amount of information that may be valuable to auditors of insurance entities, including current industry trends and developments. Some of the more relevant sites for auditors with insurance clients include those shown in the following table:

<table>
<thead>
<tr>
<th>Organization</th>
<th>Web Site</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama Insurance Underwriting Association (AIUA)</td>
<td><a href="http://www.alabamabeachpool.org">www.alabamabeachpool.org</a></td>
</tr>
<tr>
<td>Citizens Property Insurance Corporation of Florida (Florida Citizens)</td>
<td><a href="http://www.citizensfla.com">www.citizensfla.com</a></td>
</tr>
<tr>
<td>Florida Hurricane Catastrophe Fund (FHCF)</td>
<td><a href="http://www.sbafla.com/fhcf">www.sbafla.com/fhcf</a></td>
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</tbody>
</table>

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<table>
<thead>
<tr>
<th>Organization</th>
<th>Web Site</th>
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</thead>
<tbody>
<tr>
<td>Insurance Information Institute (III)</td>
<td><a href="http://www.iii.org">www.iii.org</a></td>
</tr>
<tr>
<td>Louisiana Citizens Property Insurance Corporation</td>
<td><a href="http://www.lacitizens.com">www.lacitizens.com</a></td>
</tr>
<tr>
<td>Mississippi Residential Property Insurance Underwriting Association (MRPIUA)</td>
<td><a href="http://www.msplans.com/MRPIUA">www.msplans.com/MRPIUA</a></td>
</tr>
<tr>
<td>Mississippi Windstorm Underwriting Association (MWUA)</td>
<td><a href="http://www.msplans.com/mwua">www.msplans.com/mwua</a></td>
</tr>
<tr>
<td>National Association of Insurance Commissioners (NAIC)</td>
<td><a href="http://www.naic.org/">www.naic.org/</a></td>
</tr>
<tr>
<td>Texas Windstorm Insurance Association (TWIA)</td>
<td><a href="http://www.twia.org">www.twia.org</a></td>
</tr>
</tbody>
</table>

.252 The insurance practices of some of the larger CPA firms also may contain industry-specific auditing and accounting information that is helpful to auditors.

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.253 This Audit Risk Alert replaces *Insurance Industry Developments*—2008.

.254 The Audit Risk Alert *Insurance Industry Developments* is published annually. As you encounter audit or industry issues that you believe warrant discussion in next year’s Audit Risk Alert, please feel free to share them with us. Any other comments that you have about the Audit Risk Alert also would be appreciated. You may e-mail these comments to kkushmerick@aicpa.org or write to

Kim Kushmerick  
AICPA  
1211 Avenue of the Americas  
New York, NY 10036
### Appendix—Additional Web Resources

Here are some useful Web sites that may provide valuable information to accountants.

<table>
<thead>
<tr>
<th>Web Site Name</th>
<th>Content</th>
<th>Web Site</th>
</tr>
</thead>
<tbody>
<tr>
<td>AICPA</td>
<td>Summaries of recent auditing and other professional standards, as well as other AICPA activities</td>
<td><a href="http://www.aicpa.org">www.aicpa.org</a> <a href="http://www.cpa2biz.com">www.cpa2biz.com</a> <a href="http://www.ifrs.com">www.ifrs.com</a></td>
</tr>
<tr>
<td>AICPA Accounting Standards Executive Committee</td>
<td>Summaries of recently issued guides, technical questions and answers, and practice bulletins containing financial, accounting, and reporting recommendations, among other things</td>
<td><a href="http://www.aicpa.org/Professional+Resources/Auditing+Accounting+Standards">www.aicpa.org/Professional+Resources/Auditing+Accounting+Standards</a></td>
</tr>
<tr>
<td>AICPA Accounting and Review Services Committee</td>
<td>Summaries of review and compilation standards and interpretations</td>
<td><a href="http://www.aicpa.org/Professional+Resources/Auditing+Accounting+Standards/Review+Services+Committee">www.aicpa.org/Professional+Resources/Auditing+Accounting+Standards/Review+Services+Committee</a></td>
</tr>
<tr>
<td>AICPA Professional Issues Task Force</td>
<td>Summaries of practice issues that appear to present concerns for practitioners and disseminate information or guidance, as appropriate, in the form of practice alerts</td>
<td><a href="http://www.aicpa.org/Professional+Resources/Auditing+Accounting+Standards/Professional+Issues+Task+Force">www.aicpa.org/Professional+Resources/Auditing+Accounting+Standards/Professional+Issues+Task+Force</a></td>
</tr>
<tr>
<td>Economy.com</td>
<td>Source for analyses, data, forecasts, and information on the U.S. and world economies</td>
<td><a href="http://www.economy.com">www.economy.com</a></td>
</tr>
<tr>
<td>The Federal Reserve Board</td>
<td>Source of key interest rates</td>
<td><a href="http://www.federalreserve.gov">www.federalreserve.gov</a></td>
</tr>
<tr>
<td>Financial Accounting Standards Board (FASB)</td>
<td>Summaries of recent accounting pronouncements and other FASB activities</td>
<td><a href="http://www.fasb.org">www.fasb.org</a></td>
</tr>
<tr>
<td>USA.gov</td>
<td>Portal through which all government agencies can be accessed</td>
<td><a href="http://www.usa.gov">www.usa.gov</a></td>
</tr>
</tbody>
</table>
## Insurance Industry Developments—2009

<table>
<thead>
<tr>
<th>Web Site Name</th>
<th>Content</th>
<th>Web Site</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Accountability Office</td>
<td>Policy and guidance materials and reports on federal agency major rules</td>
<td><a href="http://www.gao.gov">www.gao.gov</a></td>
</tr>
<tr>
<td>International Accounting Standards Board</td>
<td>Summaries of International Financial Reporting Standards and International Accounting Standards</td>
<td><a href="http://www.iasb.org">www.iasb.org</a></td>
</tr>
<tr>
<td>International Auditing and Assurance Standards Board</td>
<td>Summaries of International Standards on Auditing</td>
<td><a href="http://www.iaasb.org">www.iaasb.org</a></td>
</tr>
<tr>
<td>International Federation of Accountants</td>
<td>Information on standards setting activities in the international arena</td>
<td><a href="http://www.ifac.org">www.ifac.org</a></td>
</tr>
<tr>
<td>Private Company Financial Reporting Committee</td>
<td>Information on the initiative to further improve FASB's standard setting process to consider needs of private companies and their constituents of financial reporting</td>
<td><a href="http://www.pcfr.org">www.pcfr.org</a></td>
</tr>
<tr>
<td>Public Company Accounting Oversight Board (PCAOB)</td>
<td>Information on accounting and auditing activities of the PCAOB and other matters</td>
<td><a href="http://www.pcaob.org">www.pcaob.org</a></td>
</tr>
</tbody>
</table>