

RELIABLE AUTO INSURANCE: AUDITING PREMIUMS USING EXCEL

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Sydney Alston, an experienced staff auditor at MinorMars LLP, is upcoming up for promotion to senior auditor. After finishing his assigned audit procedures on the Reliable Auto Insurance engagement, Sydney is asked by his audit manager to performed some simple data analytics regarding Reliable's earned and unearned premium figures. Sydney received the data file, performed the preliminary data clean-up of the premium data, and recalculates earned premium. Once completes these audit step, Sydney realized his observations and audit conclusion may not aligned with his audit manger's expectations. Sydney needs to evaluate the effects of his observations in context the overall audit engagement, established audit strategy and professional responsibilities.

INTRODUCTION

Sydney Alston graduated eighteen months ago with a master's degree in accounting. Immediately after graduation, Sydney began working with MinorMars in the Phoenix office and was wrapping his second busy season with audit client, Reliable Auto Insurance. Working day to day with Sydney on this audit engagement were two audit seniors as well as the audit manager, Madison Cleary. Madison had been working on Reliable Auto Insurance engagement since she had been hired at MinorMars LLP. Both Sydney and Madison were up for promotion this fiscal year with the firm.

It was the end of busy season and Madison Cleary needed to finish the Reliable Auto engagement quickly. Madison Cleary asked Sydney Alston to perform few audit procedures using data analytics over a revenue recognition. Sydney Alston

performed these procedures but his conclusions conflicted with the results from control and interim testing.

AT MINORMARS, LLP – PHOENIX OFFICE

Sydney Alston glanced at the clock on his cell phone and noticed it was 2:55 pm. He had a scheduled 3:00 P.M. meeting with Madison Cleary, one of the audit managers on the Reliable Auto Insurance engagement.

Sydney finished his work papers regarding Reliable's cash accounts. Sydney started uploading his electronic work papers to the firm's cloud-based work paper system when Harper Lewis, audit senior, on the engagement, popped her head in.

"Madison wants to meet with you in 20 minutes because she has a meeting with the audit partner at 3 pm," Harper said as she closed the door.

Sydney realized 15 minutes had already passed, and his meeting with Madison was about to begin. Jumping up, he grabbed his planner and ran out the door. When Sydney arrived at Madison's on-site workspace, she was wrapping up the phone call with the Reliable's CFO, Jordan River. Sydney overheard Madison say "Yes, Jordan we are expecting to wrap our audit of premiums next week and will provide you with our proposed journal entries one week from today. Yes, I received the electronic file yesterday from your IT department. Yes, Jordan – have a great weekend as well."

"Sydney, you have been doing a great job and I would like to provide you with an opportunity to assist with the audit senior with the premium cycle," Madison said. "So far on the premium cycle is more than 50 hours over budget." Sydney slumped into the chair. "We absolutely have to wrap up these procedures quickly. Therefore, we obtained an electronic file of all of 2011 auto policies" Madison shuffled through papers on the table to locate a USB drive. "One of the remaining areas is verification of premium figures. Even though the premium cycle is currently over hours, I'd like to see it completed over the next few days. We have a limited amount of chances to bring this audit in close to budget. We believe that performing these last few audit procedures electronically will help us.

Madison continues "I have just re-assigned these procedures to you within our work paper system. Once you have completed, these steps please send a summary memo to me directly since I need to follow-up with the CFO very soon. There should not be any issues with these final audit steps since control testing and interim testing went well. I know that you will do a good job! "

Madison jumped up, handed Sydney the USB drive and left her office.

THE AUDIT CLIENT

Reliable Auto Insurance was a regional auto insurer located in Phoenix, Arizona and founded in 2004. Reliable Auto Insurance had grown to 250+ employees, \$ 6 million in annual revenue. Reliable sold automobile insurance policies and processed any related claims to these policies.

Customers could purchase a 6-month or 1-year policy auto policy. Customers must pay their policies in full at the effective date. Reliable Auto Insurance recorded revenue (premium) as the policy expired. The Company's policy with respect to pre-paid policies was to record the sold policy as an unearned premium. During month-end closing procedures, Reliable entered an accrued revenue adjusting entry to recognize earned premium.

Reliable Auto hired a public accounting firm to provide an audit of its financial statements in order to get favorable terms on financing, reinsurance and bond ratings. MinorMars has audited Reliable Auto Insurance for the past ten years and always given a 'clean opinion' regarding Reliable's internal controls and financial information.

ADDITIONAL AUDIT PROCEDURES

Sydney returned to his office and dropped his head on the desk. After a deep sigh, Sydney reviewed the codifications regarding the Accounting Standards Codification 606, "Revenue from Contracts with Customers" to gain review recognition with the context of auto insurer and Reliable's operations. Sydney felt slightly overwhelmed, but he grabbed the USB and begins to complete the remaining audit steps.

NEXT STEPS

After performing the final audit procedures regarding earned and unearned insurance premiums, Sydney Alston has audit findings. Now, Sydney has a dilemma. What findings should be communicated immediately to the Madison? What are the implications of year-end audit results that are inconsistent with prior audit result on the overall audit strategy and conclusions? As a second-year auditor, what concerns should Sydney have regarding the completion of these procedures and communication of his results? What change should be implementation for next year's audit engagement of Reliable?

EXHIBIT 1:

MinorMars 2011 Audit Program for Reliable Auto Insurance

Reference: _____
Prepared by: _____
Date: _____
Reviewed by: _____

Reliable Auto Insurance, Inc.
Sales Cycle Audit Program
Selected Substantive Tests
For the Year Ended December 31, 2011

Audit Procedures	Assertion	Initial	Date
1. Identify the population of journal entries to be selected for testing.	Completeness Valuation	MC	1/6/12
2. Examine the population for missing or incomplete policy information.	Completeness		
3. Examine possible duplicate account entries.	Completeness Valuation		
4. Examine for post-date entries.	Completeness Valuation		
5. Recalculate the premium figures	Valuation		
6. Compare audited figures to reported figures.	Valuation		

EXHIBIT 2

Reliable's 2011 Projected Premium Figures

Reference: _____
 Prepared by: _____
 Date: _____
 Reviewed by: _____

Reliable Auto Insurance, Inc.
 Sales Cycle Audit Program
 Premium Lead Schedule - PBC
 For the Year Ended December 31, 2011

(\$ in thousands)	12/31/ 2011 Projected	12/31/2010 Actuals
Revenues		
Premiums	\$ 5,912	\$ 4,982
Other-than-temporary impairment losses	(50)	(50)
Sales and other realized capital gains and losses	25	45
Total Revenues	\$ 5,887	\$ 4,977
Costs and Expenses		
Claims and claim expenses	\$ (4,138)	\$ (3,536)
Operating costs and expenses	(768)	(653)
Interest expense	(56)	(47)
Income tax expense	(150)	(127)
Total Costs and Expenses	\$ (5,112)	\$ (4,363)
Net Income	\$ 773	\$ 614

EXHIBIT 3

Additional Information to Recalculation Reliable Auto's Earned Premium Figure

Reference: _____
Prepared by: _____
Date: _____
Reviewed by: _____

Reliable Auto Insurance, Inc.
Sales Cycle Audit Program
Premium Lead Schedule – Temporary File
For the Year Ended December 31, 2011

Additional Information:

- Reliable Auto Insurance records earned premium as the policy expires. The Company's policy with respect to pre-paid policies is to record the sold policy as an unearned premium.
- At each month-end, Reliable enters an accrued revenue adjusting entry; therefore debiting unearned premium and crediting Earned Premium. Prior to the policy expiring, these pre-paid insurance policies are recorded as a liability (unearned premium).
- Reliable Auto Insurance offers four (4) types of insurance plans – Offer1 – 6 months policy paid monthly; Offer2 – 6-month policy paid in full at the effective date; Offer3 – 12-month policy paid monthly; and Offer4 – 12-month policy paid in full at the effective date.
- The Reliable Auto Insurance 2011 file has the following check figures:
 - Record count : 21,649
 - Premium (Sum): \$ 7,882,336.01
 - Monthly Premium Auto (sum): 2,025,866