# SOLUTIONS TO END-OF-CHAPTER PROBLEMS

## Chapter 2
## Managing Risk: The Role of Auditing and Assurance

**Questions**

1. Good corporate governance will lead a company to achieve its objectives. This occurs by identifying and taking advantage of opportunities and identifying and managing risks. COSO's 2004 ERM – Integrated Framework, provides a basis for managing a company's strategic, operating, reporting and compliance risks. The strength of an organization's internal environment is driven by strong corporate governance and effective monitoring processes should include board involvement, for example.

2. The five elements of COSO's Internal Control Framework over Financial Reporting are: control environment, risk assessment, control activities, information and communication, and monitoring, which are defined below.

   a. *Control environment*: The general environment in which internal control will operate including the attitudes and competence of management and employees of the organization.

   b. *Risk assessment*: The activities the organization performs to identify, assess, and prioritize risks. A breakdown in identifying or prioritizing risk will probably have a negative impact on the performance of the organization.

   c. *Control activities*: The activities the organization performs to reduce the effect of risk on its performance. The range of possible control activities in any organization is extremely broad and depends on the nature of the environment and risks that are of concern.

   d. *Information and communications*: The production and distribution of information necessary for effective internal control.

   e. *Monitoring:* The oversight of internal control to determine if it is effective.

   Though small a community bank can still have a policy on ethical behavior which is conveyed by the leadership and bought into by the employees. COSO's ERM framework should be applied to manage risks. Control activities should be particularly tight to safeguard the cash and recording of cash transactions.; cash is susceptible to theft - it is highly liquid, easily convertible, transportable, and

untraceable. Management needs information on deposits, withdrawals, bank charges, loan activity etc. on a regular basis. Bank expenses should be compared with budgeted expenses on a periodic basis. Monitoring should be performed by the Board, the management on hand at the bank, and any internal, external, state or federal bank auditors.

3. Monitoring and auditing are overlapping concepts but are also different concepts. Monitoring as restrictively defined by COSO, reflects an oversight over internal controls. Of course, COSO defines internal control broadly including financial reporting, operations, and compliance. Auditing is also much broader than financial statement auditing including compliance, operational, financial, environmental, fraud, and IT audits. The primary difference in the terms is that audits typically involve a more detailed investigation and scrutiny than is suggested by the term monitoring. Financial statement audits have traditionally focused on attesting to the financial statements with the evaluation of internal controls being an optional subobjective of that goal. Since Sarbanes Oxley, this is only true for private companies.

4. Strategies are implemented to achieve an organization's objectives. Similarly, internal controls also serve to achieve the organization's objectives A strategy might involve a totally new path such as opening a new chain of stores in Southeastern US to take advantage of an opportunity. Internal controls are typically instituted to maintain and improve existing systems to deal with risks.

5. The Control environment is a critical part of any audit concerned with management fraud. The attitudes and values of upper management and its ability to effectively convey those values to employees and get them to buy into them greatly influences internal control. Also, the ability to hire, motivate and retain competent, trustworthy employees can have a pervasive effect on the organization's internal controls and financial reporting system.

6. The auditor's report on the financial statements uses the International Reporting Standards adopted by the European Union for evaluation. The opinion was signed by PricewaterhouseCoopers LLC. The Corporate Responsibility Report used AA1000 assurance standard as the criteria for evaluation and was signed by five individuals from presumably independent organizations. The reviewers of the responsibility report indicated that they inquired with management in obtaining evidence about the report. An audit would entail the gathering of much more extensive and reliable evidence to support management's assertions in the financial statements. Previously, Shell's CRR report was verified by both PricewaterhouseCoopers and KPMG, but they moved to an external committee presumably because of the perceived expertise and credibility of the experts relative to the public accounting firms.

7. The audit failures which are highly publicized typically involve management fraud. Recognition of this led the profession to begin assessing the control

environment. This requires that the auditor formally consider the nature of the CEO and upper management. Prior to the promulgation of SAS 55 in 1987, reviews of internal control did not formally consider the possibility that the CEO, who in those times basically appointed the external auditor, could be a fraudster. Assessing the control environment requires an evaluation of the nature of upper management and the corporate culture. What are the attitudes and values of management? Has the leadership developed policies on ethical behavior, disseminated that policy and gotten employees to buy into them? Do Human Resources have appropriate policies to hire, motivate and retain competent, trustworthy employees. Is management's style autocratic, decision making centralized and/or powerful incentives distributed based on the achievement of accounting numbers? Or is the style more hands-off, which could entail another set of risks?

Screening new clients is essential to obtaining a client portfolio with the preferred risk profile.

8. In the traditional audit, auditors were required to understand and evaluate internal controls but were not required to test or report on them. Internal control testing was utilized for the audit to substitute for substantive testing when the controls were judged to be effective. The integrated audit requires that management's assertions about the effectiveness of the internal control system be tested, evaluated, and reported upon. Should the auditors find that the controls are effective, they are still able to use tests of controls to justify reduced substantive testing as under traditional audit approaches.

9. In phase one of the integrated audit, the auditor must devise a plan to obtain sufficient competent evidence to support an opinion on both the financial statements and management's assertions about the effectiveness of internal control over financial reporting. In phase two, the auditor collects the necessary evidence to corroborate management's assertions in the financial statements and its report on internal control effectiveness. The planning phase has become more significant through time, but it is the evidence gathering phase that is the most expensive and labor intensive.

10. Internal control as defined by COSO, includes controls over financial reporting, operations, and compliance. The ERM framework also assesses a firm's strategic risks which are not encompassed in its internal control framework. In other words, the internal controls under COSO's 1992 framework are a subset of controls as described under the 2004 ERM framework.

**Problems**

1. a. Critical business risks of an Internet dating service include the following:

New entrants to the market and fierce competition

Unauthorized access to the database
Lack of fit between clients
Insufficient advertising to cover database maintenance costs
Liability for personal harm caused to a client on a date from the database
Negative public perception of industry
Misrepresentation by clients in database

b. Controls to mitigate risks:
*Internal Controls*:
Managers with integrity
Well-controlled database
Secure access--password protected, firewalls, etc.
Public relations business process
Competitor database maintained
Research and development business process
Targeted marketing to increase probability of client fit

*External Controls:*
Private security investigations of client information
Assurance service to attest to representations contained in database
Paid chaperones to escort clients on first dates
Regulations impacting industry practices
Information technology consulting to improve database
Advertisers encouraging use of website

2. a. financial statements

b. reliability of information and control systems

c. compliance with laws, regulations, and contractual obligations

d. compliance with laws, regulations, and contractual obligations

e. financial statements or reliability of information and control systems

f. effectiveness and efficiency of operations

g. effectiveness and efficiency of operations

h. compliance with laws, regulations, and contractual obligations

i. relevance and context of business risk management process

j. relevance and context of business risk management process

3. Strategic risk: a competitor with a well established brand name opens shop across the street

Operations risk: Major clients are in an industry that is experiencing a major downturn and business failures.

Reporting risk: The firm's attorney is 49% sure that it will prevail in a lawsuit. However, because the loss is not probable, the liability is not being accrued.

Compliance Risk: The managing partner learns that the engagement partner for Enron, David Dinkins, has just shredded all documents relevant to the investigation.

4. The answer given will depend on the risk identified. What follows is an example of a hypothetical risk. Suppose they are concerned that they will lose customers due to problems with shipping.

Risk Identification: Shipping risk (e.g., shipping too slow, shipping costs too high, damage in shipment, goods stolen in shipment, insurance inadequate)

Management Response: Provide a forced response interface requiring customers to indicate the mode of shipment desired. Allow them to enter their zip code to precisely determine the shipping cost to them. Make insurance on the jewelry shipment mandatory. Jewelry cases must have structural integrity and packing material must be adequate.

Information Reliability: Have credit card information verified with a credit service or require they use a third-party service (e.g., PayPal).

Performance Results: Obtain feedback from customers on the quality of the shipment and the cost of handling

Reaction by management: If carriers are unreliable which delays shipment, results in damage and returns, or is not competitive costwise, then management should consider other alternatives.

5. a. *IBM*

Mission Statement: At IBM, we strive to lead in the creation, development, and manufacture of the industry's most advanced information technologies, including computer systems, software, networking systems, storage devices, and microelectronics. We translate these advanced technologies into value for our

customers through our professional solutions and business services worldwide.

Business Objectives: Be recognized as market leader in creating and selling information technology.

Provide expert solutions for information technology issues to customers.

Strategic Risk Remaining a leader in the competitive information technology industry is uncertain.

If the technology is not cutting edge, demand for its solutions will fall. Customer relationships must be maintained.

Significance of Risk IBM's position is well entrenched which is why it was sued for anti-trust in the 70s and 80s. Still there is always a low risk that they will miss a turn in the road as with the PC..

The solutions proposed might become outdated or the means for communicating these solutions may not be as effective as a competitor.

*b.* *YUM Brands* (Pizza *Hut/Taco Bell/KFC)*

Mission Statement: Put a YUM on people's faces around the world…that special eating experience that makes you smile and creates lifelong customers. Food you crave. Comeback value. Customer-focused teams.

Business Objectives: Satisfy customer needs for food that is craved.

Create loyal customers.

Strategic Risks Customer tastes may change

Customers may become more fickle with a wider range of competitors.

Significance of Risk Medium risk. Research studies warning about the risks of salt could affect all these brands.

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| | Medium risk. The range of restaurants and cuisine pose a on-going risk for a restaurant with a static menu. |

*c.* *Philips*

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| Mission Statement: | Improve the quality of people's lives through the timely introduction of technological innovations. |
| Business Objectives: | We will be a leading solutions provider in the areas of healthcare, lifestyle and enabling technology |
| | We will stay abreast of the latest technologies |
| Strategic Risks | Healthcare, lifestyle and enabling technologies may wane in their importance |
| | Technological obsolescence |
| Significance of risk | Low. Healthcare, lifestyle and enabling technologies should remain in demand as the population ages |
| | Medium. Technological innovations will always be in demand but it is not clear that Philips will be the leader. |

*d.* *Procter & Gamble*

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| Mission Statement: | We will provide products of superior quality and value that improve the lives of the world's consumers. As a result, consumers will reward us with leadership sales and profit growth, allowing our people, our shareholders, and the communities in which we live and work to prosper. |
| Business Objectives: | Be the market share leader for consumer products offered by the company. |
| | Maximize shareholder value. |
| Strategic Risks | Saturation of market |
| | Risk a product might harm people |

Significance of Risks Low. The global market place is far from saturated.

Low. Most of P&G's products are relatively safe and time tested. New consumers in different countries might have a different experience however.

*e. The Walt Disney Company*

Mission Statement: Disney's overriding objective is to create shareholder value by continuing to be the world's premier entertainment company from a creative, strategic, and financial standpoint.

Business Objectives: Be perceived as the most creative entertainment company.

Maximize shareholder value through financial performance and intangibles.

Strategic Risks New competitors, new technology

Taste for existing products might change.

Significance of Risks Medium. The number of competitors in children's movies and theme parks is growing.

Low. Bambi is not MTV but its appeal cuts across generations

6. a. *McDonald's*

Avoidance: McDonald's does not sell roast beef products (like Hardee's), possibly because they do not have a process for incorporating the necessary equipment to efficiently serve customers

Insurance: McDonald's likely carries liability insurance policies regarding lawsuits stemming from spoiled food served to customers. Several years ago, Burger King suffered losses when a supplier delivered meat tainted with e coli to several locations.

Reduction: McDonald's has strict operating policies for its franchises to help ensure that the product tastes the same in all of its locations. Specific equipment must be purchased by

franchisees and preparation procedures must occur according a formal plan.

Acceptance: McDonald's issues franchises instead of owning restaurants. An inherent risk of franchising is placing control of operations in the hands of franchisees all over the world. Should franchises not follow established policies, the trademark can be negatively impacted from associated negative publicity.

b. *Nike*

Insurance: Nike more than likely carries significant liability insurance related to the production and sale of its sporting equipment. Should an athlete be seriously injured while wearing the company's shoes or using its equipment, the possibility exists that injured parties will involve the company in a lawsuit.

Reduction: Nike has been involved in a scandal involving the production of its products in underdeveloped countries, where employees are often young and paid an extremely low wage. Rather than discontinue production in these countries, Nike has chosen to implement a series of controls and policies aimed at improving the working conditions and preventing any further problems in the future. The company has even invited its key alliance athlete, Michael Jordan, to become involved in the monitoring process. Jordan has thus far chosen not to be involved in this situation because of other commitments.

Acceptance: Nike elevated the trend of creating alliances with athletes to wear and promote its products. Knowing that many of these 18-25 year-old millionaires are prone to engage in unlawful and questionable acts, Nike has accepted the associated risks by continuing to increase the number of athletes with which the company has contracts. Occasionally, athletes cross the line of acceptability, however, (Atlanta Falcon's safety Eugene Robinson's solicitation of a prostitute the week prior to the Super Bowl comes to mind) and Nike is forced to terminate its relationship with the athlete involved.

Avoidance: Nike has entered most sports-related product and apparel markets over the years; however, they have yet to enter the recreation provider market. The company has opened Nike Town outlets to sell its merchandise, but has yet to open venues to participate in sporting events using Nike-produced equipment and promoted using Nike-affiliated athletes. The recreational industry is risky, with the exception perhaps of golf courses.

c. *The Home Depot*

Acceptance: The Home Depot is a retailer that realizes a significant portion of its profitability from the economies of scale created by selling goods in a warehouse format, essentially making each location a distribution center. Therefore, The Home Depot needs to ensure that a high volume of consumers shop at its location. Thus far, the company has avoided building stores in locations that would require a significant commute by customers, choosing only to build in densely populated areas.

Insurance: Each Home Depot store likely is insured against theft or damage due to fire or natural disaster. Because of the size of each store and the number of inventory items at each store, the financial impact associated with these events could be material to the operation.

Avoidance: Home Depot avoids this risk by conducting market analysis to determine where to build. This ensures a high enough volume to cover costs.

Reduction: The Home Depot reduces the risks associated with distributing 40,000 to 50,000 different types of products to each of its 800+ stores by centralizing its purchasing process and utilizing six sigma to ensure that its inventory does not result in any stock outs.

7 a. This is a management control as the hiring of competent, trustworthy employees is an overriding strategic concern. It is most unusual that the controller is involved with the hiring of internal auditors. Hopefully, this involvement is limited to offering suggestions to the audit committee.. Since internal auditors evaluating the accounting systems for which the controller is responsible, they should remain independent of the controller

and not beholden to him or her. In most modern organizations, professional internal audit functions report directly to the audit committee or CEO and not to the controller

b. This is a business process control. This control exhibits both *high diagnosticity and high objectivity* because the imbedded automated control should flag any entry over a specified level with a high degree of reliability. The control should also be objective given the involvement of both an executive of the organization and the independent auditor.

c. This is a management control. This control has *high objectivity* because the risk committee involves corporate executives and (presumably) outsiders to the company. The control should have *high diagnosticity* unless no members of the risk committee have the appropriate skills or knowledge to effectively assess risk management initiatives.

d. This is a management control. This control could exhibit *high objectivity* because the vice president is interested is reviewing the performance of the plant managers. However, this control could exhibit *low diagnosticity* unless the vice president performs follow-up procedures to ensure that managers truthfully self-reported reasons for variances.

e. This is a management control to monitor a business process. This control exhibits both *high diagnosticity* and *high objectivity* because the independent intermediary should be an expert at ensuring that the ERP system is being designed and implemented according to contractual obligations. Being independent from the ERP provider helps ensure objectivity. The client should carefully investigate the relationship between the ERP provider and the consultant, however. Often the consultant has an alliance with the ERP provider, which can reduce the objectively to some degree.

8. The following describes how Amazon.com might conduct the risk management process for the risk that Barnes & Noble might effectively exploit a competitive advantage of having retail stores effectively market its B&N.com business unit.

Risk Assessment: Amazon.com should carefully monitor Barnes & Noble's marketing efforts for its B&N.com business units (by visiting stores, monitoring websites for advertising, and monitoring its website). Further, Amazon.com should survey book consumers for recognition of both companies' websites and how they learned of the websites (for internet awareness, Amazon.com can gain access to the number of hits to its advertisements, but the Company cannot get this information for B&N.com).

Response by Management: Amazon.com likely subscribes to the notion that "the best defense is a strong offense" and intensifies its own marketing efforts whenever it perceives that B&N's marketing efforts are being successful. Because Amazon does not have retail operations, it must create alliances with marketing outlets.

Information Reliability: Amazon.com needs to assess the reliability of information suggesting success or failure of B&N.com to successfully market its operations at the expense of Amazon. One way to address this issue is to hire a professional accounting firm to provide an assurance service on the reliability of the information systems used to gather competitor data.

Performance Results: Performance results can materialize on several dimensions, some of which will directly impact the financial statements. Marketing expenses should dramatically increase in periods in which B&N.com has been identified as successfully influencing consumers through its on-site marketing efforts. Successful performance by Amazon.com might be demonstrated through statistical relationships identified (correlation, etc.) through consumer feedback (via surveys, hit rates, etc.) and sales of products identified as preferred by those surveyed.

Reaction by Management: Management response to risk management performance results is an important last step in the risk assessment process (prior to restarting the loop). Amazon.com's managers should carefully and critically evaluate whether its response to the risks of losing business to B&N.com through marketing efforts at stores have been effectively mitigated. For example, success by Amazon might not reflect mitigation of the in-store risk; rather, it could be linked to outperforming B&N.com on website advertising. Perhaps the on-site marketing efforts will not be realized for a period of time, such as the following holiday season. Managers need to carefully re-examine whether performance measures properly reflect success or failure at mitigating risk.

9. See the solution provided on the following page.

| Process Step | Management Perspective | Auditor Perspective |
|---|---|---|
| Risk Assessment | Management identifies and evaluates risks resulting from chemical emissions by their company. They have identified environmental risks from air water pollution. | The auditor is concerned that management has identified all potentially critical environmental and assessed their significance accurately. Missing or under-appreciated environmental risks will not be effectively managed. |
| Response by Management (Risk Control and Mitigation) | Though it is not clear from the information provided the extent to which environmental risk have been avoided, insured against, it appears BASF is not accept environmental risk but rather is attempting to reduce them. BASF has set goals that by 2010 they will reduce greenhouse gas emissions by 10%, air pollutants by 40%, Water emissions of organic substances and nitrogen by 60% and water emissions of heavy metals by 30% Management makes choices about how to respond to specific risks. Choices include avoidance, acceptance, insurance or reduction. Risk reduction involves designing business processes to address groups of related risks. Internal policies and procedures are designed to guide the actions of individuals within the organization. | The auditor assesses whether management's responses to risks are likely to be effective. Has management designed business processes to address environmental risks? Has BASF instituted the necessary policies and procedures to prevent, detect, and provide feedback on these risk exposures? The corporate report suggests that BASF is making significant progress toward reducing their environmental impact. |
| Information Reliability | BASF has an information systems designed to provide appropriate environmental feedback. | The auditor assesses the reliability of environmental measurement data and reporting. Much of the information that an auditor needs comes from internal processes. The more reliable the environmental management information, the fewer problems the auditor can expect during the engagement. |
| Performance Results | The Corporate Report indicates that BASF is on track to meet their environmental goals. | Environmental performance measurement information gives the auditor a basis for judging management's control of environmental risks. Early feedback suggesting environmental goals are not being meet could suggest problems elsewhere relevant to the audit. |

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| Reaction by Management | Management reacts to environmental performance data and decides whether adjustments are needed in strategic decisions, business plans or business processes as a result of existing circumstances or potential future problems. | The auditor judges management's willingness and ability to react to changes in environmental conditions or risks. If reactions are inadequate, the auditor may expect problems to be revealed by the audit and may offer assistance. To date, BASF reported performance suggests there reactions are adequate. |

**Cases**

**2-1 Equiticorp Holdings LTD.**

Equiticorp Holdings' unique corporate governance structure has many audit implications. First, management's incentives and the owners' incentives are almost perfectly aligned. This nearly eliminates the potential moral hazard that could arise if the owners did not possess the same information as the managers and their interests were in conflict. Some risk still exists because two directors are not executives and the other director/executives might desire larger salaries which would hurt the two outside directors' interests. Typically, the audit committee is composed solely of outside directors. With the external and internal auditors, they exercise oversight over management. In this organization, it is not clear how they would structure the audit committee or compensation committee to achieve strong corporate governance.

The control environment starts with Allan Hawkins. He is a strong leader who seems driven by an accounting result, the bottom line, and also seems focused on short term results (e.g., "live … on a deal by deal basis"). The Staff's shareholdings also provide a considerable incentive to succeed. Management and employees are competent; however, the CEO is numbers driven and is not constrained by a strong corporate governance structure. This increases the auditor's perceived audit risk and fraud risk

The organization structure is flat. This suggests that the span of control is potentially too large, (i.e., too many employees working for one boss). This further suggests less direct oversight by someone with more knowledge and experience since the boss's monitoring time is spread over more employees. Less monitoring implies greater audit risk.

The absence of a personnel department also raises questions about the control environment since the hiring of competent, trustworthy employees is the foundation of a good control environment.

The amount of money transacted, the size of the deals, and the complexity of the transactions put a large burden on accurate accounting. It is not clear that this simple corporate structure is adequate to generate reliable financial data on these deals.

## 2-2 Insignia Textiles Limited

Strengths:

a. The corporation has created a code of conduct to set an ethical standard for treating employees, suppliers and customers
b. Each employee has a contract with a description of their job
c. The audit committee has two outside directors on it.
d. Employees are given aptitude tests to determine whether they are likely to succeed.

Concerns:

a. It is not clear to what extent management has stood behind the code of conduct, disseminated it to the employees, obtained not only their acknowledgement of it but also their acceptance of the ethical code. How strict and quick is management in enforcing this code?
b. Formal job descriptions are a starting point but employees job responsibilities often require going beyond their narrowly defined job description
c. Aptitude tests suggest a level of potential competency but not work effort, character or ethics. Job references should be checked.
d. The board typically meets at least four times a year. This is necessary for most dividend paying companies as the Board must vote each quarter how large a dividend to pay. Meeting twice a year may suggest weaker corporate governance. Similarly, the audit committee, which includes two former executives and other current executives, should have only outside directors and should meet more often.

Further information required:

a. As mentioned in Concern (a) above, how does management use the code of conduct?
b. This must be a privately held company since it does not meet the requirements to be public listed (e.g., audit committee has inside directors on it. Why is this privately held firm interested in an audit? What is the purpose of the audit?
c. Why does the Board meet so infrequently? Does the company have an internal control function and what is its budget and the competence and objectivity of its personnel?

**2-3 Ucantrustus Builders, Inc.**

1. Generally, there are four conditions that must be met for an engagement to qualify as an attestation engagement:

   a. There must be an assertion being made by one party, the accuracy of which is of interest to another party. This assertion may be quantitative or qualitative in nature.

      In this case, Ucantrustus is making the assertion that the homes they construct are of high quality and meet current building codes and requirements. The accuracy of this assertion would be of interest to potential homebuyers.

   b. There must exist agreed-upon and objective criteria that can be utilized to assess the accuracy of the assertion. All parties must agree as to how the assertion is to be evaluated using a common unit of measure and measurement technology. The measurement approach should be refined enough to allow different individuals to arrive at conclusions that are not materially different.

   c. You and Ucantrustus would have to agree on the above points. The agreement must be in writing and be specific.

   d. The assertion must be amenable to verification by an independent party. That is, the accountant must be able to obtain adequate, diagnostic evidence to support or refute the assertion being made.

      It is likely that in addition to agreeing to do the attestation engagement, you would need to hire experts in the fields of structural engineering, architecture, and construction to test and verify the design and construction of the houses. Your tasks would need to focus on control over Ucantrustus' compliance with building codes and practices and the internal controls that assure uniform application of those practices.

   e. The accountant should prepare a written conclusion about the accuracy of the assertion(s).

2. Generally the overall objective of an attestation engagement for Ucantrustus would be to attest to the assertion that homes constructed by Ucantrustus are of high quality and meet current building codes and requirements.

3. The stakeholders would include Ucantrustus Builders, you (the CPA), and any users specified in the attestation agreement. Specified users might include potential homebuyers, insurance companies insuring homes built by Ucantrustus, and financial institutions holding mortgages on homes built by Ucantrustus.

   Attestation standards require that a specified user not only be identified, but should participate in the engagement by agreeing to the procedures that will be performed. In this case, it would be unlikely that Ucantrustus could identify the specific potential homebuyers for whom the attestation of high quality would be of most interest. As surrogates, Ucantrustus could specify state's insurance commissioner and/or the local realtors' association as the specified users. Representatives would have to agree to the planned procedures and would be the recipients of the resulting attestation report.

4. The assertions being tested include assertions about compliance with building requirements and codes and the quality of the finished product. Criteria would include local building codes and regulations, homeowners' levels of satisfaction, and whether the homes can withstand future hurricanes. Appropriate measurements would include the number of building code violations recorded, the dollar amount of fines imposed on Ucantrustus, a satisfaction index related to the satisfaction of recent homebuyers, a storm rating indicating how strong of a hurricane the home could withstand, or a wind rating indicating how well the home would withstand winds of varying intensity. Such storm ratings would probably need to be established for the overall home and separately for exterior walls, roofs, windows, and doors.

5. It should be fairly easy to establish the degree to which Ucantrustus adheres to building codes and regulations. This would require testing of Ucantrustus' related internal controls and then hiring inspection experts to test a sample of completed homes and homes under construction to determine if any codes were violated. On the other hand, establishing that the home would actually withstand hurricane force winds with minimal damage incurred is more difficult. Obviously you cannot subject the actual homes to such conditions. However, the industry may have already tested the various building techniques recommended by the building codes. There should be data and research that shows that such techniques do mitigate storm damage. However, an outside expert may be necessary to evaluate such research.

6. Preliminary Audit Program for Attesting to Building Code Compliance

   a. Obtain a copy of the local building codes. (Restrict the codes tested to those aimed at improving a home's "storm worthiness.")

b. Obtain a copy of Ucantrustus' training manual as it relates to the training of supervisors and construction workers in the areas indicated in (a) above.

c. For the period since Hurricane Andrew, obtain a listing of all homes constructed or under construction by Ucantrustus and repaired or being repaired by Ucantrustus.

d. Prepare a flowchart showing Ucantrustus' building code compliance processes.

e. Identify key building codes from the codes identified in (a) above.

f. Select a random sample from (c) above.

g. Test the random sample from (f) for compliance with the key building codes identified in (e) above.