Memorandum

To: Steve Ludwig

From: Evan Minter, Gabe Patton, Kya Sanchez

Re: Preliminary Audit Plan

Date: November 19, 2021

For the year ending December 31, 2021 we have organized a preliminary audit plan for The Allstate Corporation. This publicly traded company is an insurance company that provides protection to its clients. Allstate is known for providing home, auto, life, and other types of insurance to its clients. Recently, they have expanded their product line to include accident forgiveness, new car replacement, identity protection, appliance repair, and car-sharing. Their business model revolves around the convenience of local agents that are able to provide a unique plan for their client’s lifestyle. There is also a significant focus on customer retention in order to continuously generate income from premiums as well as having the opportunity to provide additional products to help clients navigate against uncertainty in their life. While the industry was heavily impacted from the pandemic, insurance companies were able to adapt by utilizing virtual and digital tools to stay connected to their clients and be able to provide personal service while still maintaining internal controls. The industry has since been able to recover and have pivoted to a post pandemic growth strategy. Allstate was able to reinvest funds into their employees by raising their minimum wages and by providing funds to allow employees to effectively work in a remote environment. While carriers have had to increase spending, over half of carriers anticipate higher revenues and an improved bottom line going forward despite the ongoing pandemic.

We chose to set audit risk at very low at 1%, seeking a 99% confidence in the financial statements. Additionally, we chose to set our materiality levels at the lower percentages for our benchmarks to ensure there are no material misstatements in the financial statements. The Allstate Corporation is a publicly traded company whose financial statements are looked at by both small individual investors and large investment groups like Blackrock Investments. They are among the largest of American insurance companies in terms of market share, size, and revenue. Finally, because they are an insurance company, many of their clients depend on their performance for retirement planning and the safety of their personal assets. For these reasons we are seeking the lowest possible chance that the financial statements are materially misstated. Our preliminary assessment of inherent risk would be assessed at high. By nature, the insurance industry is in the business of protecting against uncertainty. The highest source of revenue for Allstate comes from premiums paid for plans that are estimated in nature, and a significant amount of those premiums are listed as unearned on Allstate’s balance sheet. Since there is a heavy reliance on management’s assertions of accurate estimation and valuation, the inherent risk is assessed at high. While the inherent risk is assessed at high, our assessment of the control risk is low. Allstate’s internal audit department is rated as one of the best in corporate America with a strong corporate structure and strong internal controls. One of their three major values is integrity, this corporate culture is enforced from the top down as they ensure all their employees and managers conduct themselves with integrity. Additionally, they are rated by the Ethisphere Institute as one of the world’s most ethical companies. Their department is also constantly remaining at the forefront of technology and is currently implementing automation to reduce human error and improve efficiency for their internal audit. The audit committee meets eight times annually, or twice quarterly, to discuss current performance and changes or issues they find with financial statements during their meetings. We feel that the committee meets often enough to be constantly dialed in to the company. The risk of material misstatement due to fraud is assessed at a moderate risk. This takes into account the high level of inherent risk due to the nature of the industry and accounts that is significant to Allstate, as well as the low control risk due to the strong internal controls that Allstate was able to establish and maintain. External events that we would investigate further are the two big hail storms that took place in the summer of 2021 that would’ve caused Allstate to pay out large sums for coverage. Additionally, Allstate was reporting lower net income numbers for the 2021 fiscal year in comparison to previous years. Based on Allstate's 10-Q they are reporting 37% less comprehensive net income in their second quarter compared to the previous year, and an overall 131% decrease in comprehensive net income over the first six months of 2021 compared to 2020. Taking the first six months of 2021 into account Allstate reported a comprehensive net loss. These external events along with a decrease in net income compared to last year could provide incentives to commit fraud among management.

Our preliminary analytical procedures revolve around financial statement ratios of the current year and comparing them to Progressive, a competitor similar to Allstate, along with Allstate's ratios of previous years. We chose certain ratios to see how Allstate is able to manage its assets and investments in order to pay out its claims. We also chose Progressive as a benchmark since it is in the same industry as Allstate with a large market share. With concern to the ratios, our team noticed that the current ratio from 2020 to 2021 jumped over 10% which was most likely caused by an increase in investments. The decrease in the return on assets ratio can be explained by an increase in assets (investments) from 2020 to 2021. With regards to comparing Allstate’s ratios to Progressive’s, Allstate’s combined ratio is 5% higher than Progressive’s. This can be attributed due to the unexpectedly high claims as a result of the hailstorms during the summer of 2021. Allstate’s return on revenues is significantly higher than Progressive’s which can be a cause for concern since their return on equity is half that of Progressive’s. This could be caused by Progressive having a higher sales volume than Allstate. For the nine months of reported income statement figures there have been huge decreases in regard to net income and earnings per share when compared to 2020. The cause of the decrease was a net loss from discontinued operations with a large loss on disposition. However, before discontinued operations, Allstate saw a 28% increase in net income.

In summary, Allstate provides a variety of insurance products to its clients and receives most of its revenues from the premiums of the plans it provides. Because they are a publicly traded company, we chose to set materiality levels at low to ensure there is a lower risk of a misstatement. Due to the nature of the industry, inherent risk is assessed at high, but because Allstate has a strong ethical corporate culture along with some of the best internal controls and internal auditing department, control risk is assessed at low. Our preliminary analytical procedures are based on ratio analysis and comparative income statement analysis of current and previous years along with a benchmark in Progressive, a competitor in the same industry. Attached are our preliminary analytical procedures.

