FINANCIAL STATEMENTS OF LIFE INSURANCE COMPANIES

Thesis for the Degree of Ph. D.

MICHIGAN STATE UNIVERSITY

ROBERT HUGH RAYMOND

1964

This is to certify that the

thesis entitled

Financial Statements of Life Insurance Companies

presented by

Robert H. Raymond

has been accepted towards fulfillment of the requirements for

Ph. D. **degree in** Accounting & Finance

Herbert E. Miller

Major professor

Date November 5, 1964

O-169

ABSTRACT

FINANCIAL STATEMENTS OF LIFE INSURANCE COMPANIES

by Robert Hugh Raymond

The financial statements of life insurance companies are designed to help state officials protect policyholders. Use of these special-purpose statements as the only financial data in annual reports to stockholders is being severely criticized. Before stockholder-oriented statements can be developed, a clear understanding must be reached concerning the precise differences between the financial statements of commercial and industrial firms and the special-purpose statements of life insurance companies, as well as the reasons for these differences. This thesis contributes to such understanding by (1) tracing the historical development of the underlying frameworks of these two systems of financial reporting and (2) adjusting the statements of sample companies to conform as nearly as possible to the generally accepted accounting principles which are applied in the preparation of traditional financial statements. No changes are considered in the uniform regulatory report known as the Convention Blank.

Several contrasts were uncovered by the application of these two research techniques:

1. The financial statements of life insurance companies are policyholder-oriented rather than stockholder-oriented.

2. The basic methodology in the preparation of life insurance company financial statements is valuation of liabilities and assets rather than allocation of costs and expenses against realized revenue.

3. Commercial and industrial financial statements assume a going concern and are built upon a framework of double entry bookkeeping summarized into financial statements emphasizing accountability by management. The earnings statement is more important than the balance sheet.

The financial statements of life insurance companies are built around a balance sheet which is not founded on double entry and the going concern assumption. It is, instead, an elaborate formula for the computation of legal surplus. The state insurance authorities use this surplus as a first-line indicator of solvency. This solvency is, however, forward looking.

4. Balance sheet conservatism is emphasized in life insurance reports, apparently on the theory that if a surplus is shown under the restrictions imposed, state officials may justifiably assume that the company has sufficient resources to carry out the provisions of every policy in force. In accounting for unregulated businesses, conservatism is balanced with other principles and requires consideration of its effect on future earnings as well as the immediate balance sheet.

The adjustments applied to the Convention Blank statements of the sample companies have a material effect on the reported earnings of some of the companies and a mild effect on others. Important factors include age of the company, rate of growth, reserve valuation methods employed, investment practices, and types of insurance sold. Greatest impact of the adjustments occurred in firms which were undergoing change. Lack of major impact on the earnings of well-established, stable companies must not be allowed to divert attention from the need for stockholder-oriented statements in other firms.

The detailed schedules of the Convention Blank contained sufficient information for most of the adjustments. With the exception of factors relating to direct acquisition costs of life insurance policies, the only important assumptions which were necessary involve information which should be readily available to the companies in practice. Before the reporting of direct acquisition costs can be brought into conformance with generally accepted accounting principles, certain additional information must be compiled by the companies. Automatic data processing equipment might now make this practical.

Before the adjustments could be made, a model set of financial statements which conform with generally accepted accounting principles had to be designed. It is believed that if technical details can be solved at the company level, simplified versions of these model statements could be included in reports to stockholders accompanied by a complete and unqualified opinion of the certified public accountant.

Copyright by
ROBERT HUGH RAYMOND
1965

FINANCIAL STATEMENTS OF LIFE INSURANCE COMPANIES

by

Robert Hugh Raymond

A THESIS

Submitted to
Michigan State University
in partial fulfillment of the requirements
for the degree of

DOCTOR OF PHILOSOPHY

Department of Accounting and Financial Administration

1964

7-9-65

ACKNOWLEDGMENTS

The assistance and cooperation of many persons helped make the preparation of this thesis a stimulating and rewarding experience. Deep appreciation is extended to Professors Herbert E. Miller, Milton B. Dickerson and Thomas L. Wenck for their sound advice, guidance and assistance. Dr. Miller suggested the topic and, as chairman, was a constant source of inspiration and encouragement.

Many other persons should be mentioned, but space does not permit identification of each personally. The officials and employees of the Nebraska Department of Insurance deserve a special word of thanks. Every controller, actuary and accountant who read the portion of the original draft applicable to his company or client willingly gave of his time and knowledge to discuss troublesome areas and offer constructive criticism. Fellow faculty members at the University of Nebraska were always willing to discuss concepts. The typing of Mrs. Helen Faust speaks for itself.

A special word of appreciation goes to my wife, Agnes, and to Gary, Karen and Linda for their contributions.

R. H. R.

TABLE OF CONTENTS

		Page
LOCATION OF DISCUSSION OF ADJUSTMENTS		vii
LIST OF TABLES		x
Chapter		
I	INTRODUCTION	1
II	COMPARISON OF THE HISTORICAL DEVELOPMENT OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND THE LIFE INSURANCE CONVENTION BLANK	2
	The Development of Statements Which Conform With Generally Accepted Accounting Principles . .	12
	The framework	14
	Building on to the framework	19
	Development of generally accepted accounting principles	25
	Development of the Life Insurance Convention Blank	38
	Structure of the present blank	38
	The questionnaire period	43
	The first financial statement forms	45
	The static period under the Convention Blank	54
	The 1951 revision of the Convention Blank	59
III	TYPES OF ADJUSTMENTS NECESSARY IN ORDER TO EXTEND THE FINANCIAL STATEMENTS OF LIFE INSURANCE COMPANIES TO CONFORM WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES	64
	Revised Financial Statements	66
	Generally accepted accounting principles	66
	Primary objectives of the financial statements	69
	Adjustments Applicable to Many Companies . .	71
	Group I adjustments	71
	Group II adjustments	81
	Group III adjustments	91
	Group IV adjustments	92
	Group V adjustments	110

Chapter		Page
IV	THE COMPANIES ANALYZED IN DETAIL	115
	Company A	117
	History	117
	Adjustments peculiar to Company A	118
	The financial statements	118
	Exhibit I: Comparative earnings statement	131
	Exhibit II: Reconciliation	132
	Exhibit III: Balance sheet	133
	Company B	134
	History	134
	The financial statements	134
	Exhibit I: Comparative earnings statement	143
	Exhibit II: Reconciliation	144
	Schedule II(A): Detailed schedule of adjustments	145
	Exhibit III: Balance sheet	146
	Company C	147
	History	147
	Special study	148
	Adjustments not previously discussed	149
	The financial statements	153
	Some interesting side issues	154
	Exhibit I: Comparative earnings statement	156
	Exhibit II: Reconciliation	157
	Schedule II(A): Detailed schedule of adjustments	158
	Exhibit III: Balance sheet	159
	Company D	160
	History	160
	Adjustments not previously discussed	161
	The financial statements	166
	Surplus notes	167
	Exhibit I: Comparative earnings statement	174
	Exhibit II: Reconciliation	176
	Schedule II(A): Detailed schedule of adjustments	178
	Exhibit III: Balance sheet	180
	Schedule III(A): Working capital	181
	Company E	182
	History	182
	Adjustments not previously discussed	183
	The financial statements	187
	Exhibit I: Comparative earnings statement	191
	Exhibit II: Reconciliation	192
	Schedule II(A): Detailed schedule of adjustments	193
	Exhibit III: Balance sheet	194

Chapter | Page

Company F 195

History 195
Adjustments not previously discussed 196
The financial statements 196
Exhibit I: Comparative earnings statement 200
Exhibit II: Reconciliation 201
Schedule II(A): Detailed schedule of adjustments 202
Exhibit III: Balance sheet 203

Summary 204

V MATERIALITY OF THE ADJUSTMENTS FOR A WIDE RANGE OF COMPANIES 206

The Remaining Nebraska Stock Companies . . . 207

Company G 208
Company H 212
Company I 215
Company J 218
Company K 221
Company L 224

Ten Foreign Companies 232

Company M 234
Company N 239
Company O 242
Company P 248
Company Q 252
Company R 256
Company S 262
Company T 266
Company U 270
Company V 273

Summary 277

VI CONCLUSIONS 280

Basic Frameworks 281

Feasibility of Making the Adjustments in Practice . 283

Materiality and Significance of the Adjustments . 286

The Revised and Extended Financial Statements . 292

Summary 296

Page

BIBLIOGRAPHY OF WORKS CITED AND MAJOR SOURCES CONSULTED . . 298

APPENDIX I: TABLE 7--UNDERWRITING AND OTHER STATISTICS ON THE FOREIGN COMPANIES ANALYZED 311

APPENDIX II: WORKSHEET USED TO EXTEND CONVENTION BLANK STATEMENTS TO CONFORM WITH "GENERALLY ACCEPTED ACCOUNTING PRINCIPLES"--LIFE INSURANCE COMPANY F, 1962 312

APPENDIX III: SELECTED PAGES FROM 1962 CONVENTION BLANK FORM . 317

LOCATION OF DISCUSSION OF ADJUSTMENTS

Number	Title of Adjustment	First Encountered Or Discussed In: Chapter	Company	Page
Group I--Place non-admitted assets on the statements:				
1	Supplies, stationery and printed matter	III		74
2	Advances to agents or officers	III		74
3	Loans considered inadmissible	III		75
4	Agents' debit balances	III		75
5	Premium notes, etc. in excess of net value and other policy liabilities on individual policies	III		79
6	Insurance premiums paid in advance	III		79
7	Bills receivable	III		80
8	Foreign exchange	III		81
9	Returned checks and remittances	IV	C	149
10	Miscellaneous	IV	C	149
11	College Plan notes	IV	D	161
12	Deposit in industrial bank	IV	D	161
13	Receivables from other companies	IV	D	162
14	Premiums in course of collection	IV	F	196
15	Mortgage loans	V	L	231
16	Underremittances	V	N	239
17	Stocks of doubtful value	V	S	262
18	Accrued interest receivable	V	U	270
19	Accident and health insurance premiums over three months past due	V	V	273
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:				
20	Bonds	III		85
21	Stocks	III		87
22	Mortgage loans	III		91
23	Unrealized profit in mortgage loans	V	R	258
23a	Investment real estate	V	T	269
24	Stock in subsidiary corporation	IV	C	150
25	Change in capital gains as a result of other adjustments in this group	III		91
Group III--Provide for possible losses on certain assets:				
30	Agents' debit balances	III		92
31	Non-admitted current assets	IV	D	162
32	Provision for loss on certain stocks	IV	D	162
33	Uncollectible receivables	V	T	266
34	Accident and health insurance premiums over three months past due	V	U	273

Number	Title of Adjustment	First Encountered Or Discussed In: Chapter	Company	Page
Group IV--Defer a portion of acquisition costs to future periods:				
40	First-year life insurance commissions	III		104
41	Accident and health insurance commissions	III		107
42	Accident and health insurance direct acquisition costs	III		109
43	Single premium life insurance commissions	IV	B	135
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at amortized cost:				
50	Record furniture and equipment	III		112
50a	Record electronic data processing equipment (when necessary to distinguish from furniture and equipment)	V	Q	255
51	Record depreciation of furniture and equipment	III		112
51b	Record depreciation of electronic data processing equipment (when included in 50a)	V	Q	255
52	Reverse entry for change in net book value of furniture and equipment	III		113
52a	Reverse entry for change in net book value of electronic data processing equipment (when necessary to distinguish from furniture and equipment)	V	R	258
52b	Reverse entry for change in net book value of special home office equipment	V	R	258
53	Reverse write-up of value of land and buildings	IV	C	150
54	Reverse placing of value of furniture and equipment on the books by the company	IV	C	151
55	Record depreciation of home office building	IV	D	162
56	Reverse company's write-down in lieu of depreciation	IV	D	162
56a	Reverse company's write-down in excess of depreciation in Exhibit 2 of Convention Blank	V	Oq	243
57	Change in capital gains as a result of previous adjustments in this group	IV	D	163
58	Record cost of credit insurance agencies as an asset	IV	D	166
59	Record amortization of cost of credit insurance agencies	IV	D	166
59a	Capitalize permanent additions to buildings	V	M	238
59b	Record depreciation of permanent additions to buildings	V	M	238

Number	Title of Adjustment	First Encountered Or Discussed In		
		Chapter	Company	Page
Group VI--Transfer certain losses and expenses to the proper year and correct minor errors in the Convention Blank:				
60	Retroactive income tax on 1958 income	IV	B	144
61	Error in listing amortized value of bond	IV	B	144
62	Eliminate excessive accrual of income taxes	IV	C	151
63	Past services portion of pension plan	IV	C	152
64	Reverse accruals which are really appropriations of surplus	IV	E	183
65	Reverse charge to expense for group disaster contingency reserve	IV	E	186
66	Transfer treasury stock to a negative capital account	V	Q	255

LIST OF TABLES

Table		Page
1.	Selected Lines from Exhibit 13 of the 1962 Convention Blank of Company F	40
2.	Selected Lines from Exhibit 5 of the 1962 Convention Blank of Company F	41
3.	Format of Statement Included in 1850 Report of Mutual Life Insurance Company to Comptroller of the State of New York	45
4.	Percentages of Selected Assets to Total Assets in Five Companies Reporting to New York Superintendent of Insurance in 1870	53
5.	Comparison of Selected Totals for the Firms Subjected to the Abbreviated Analysis	278
6.	Comparison of the Increase (Decrease) in Net Income Computed in Conformance With Generally Accepted Accounting Principles Over the Net Gain from Operations per the Convention Blank	288
7.	Underwriting and Other Statistics on The Foreign Companies Analyzed	311

CHAPTER I

INTRODUCTION

Financial statements are included in the annual reports to stockholders because they provide a concise summary of the financial activities of the firm. The form and content of these statements are dependent in part upon the underlying assumptions regarding the business and the purposes the statements are intended to serve. The financial statements of regulated financial institutions do not rest upon the same assumptions as those accepted for commercial and industrial firms. Regulatory statements are designed to provide the data which government officials require in order to carry out their statutory duties. The goal is to provide information which will be studied by and presumably useful to experts in the regulatory agency.

A difficult situation arises when special purpose statements prescribed for regulatory purposes are included in annual reports to stockholders or are otherwise presented to the general public. This was not a matter of serious concern before 1930 because the financial information in reports to stockholders prior to that time was scanty. Since then, the quality and quantity of financial information in annual reports of commercial and industrial firms have been greatly improved, and the typical stockholder has acquired reasonable skill in reading and understanding ordinary financial statements. However, casual observation indicates that he often intuitively assumes that all statements can be read in the same manner. If the statements for a particular industry are special-purpose regulatory reports

based on different assumptions and constructed on a different framework than the rest of the statements the stockholder receives, misinterpretation is apt to occur. This is especially likely if the special-purpose statements look like traditional statements.

Nature of the problem studied

The financial statements included in the reports to stockholders of life insurance companies are especially subject to misinterpretation because the state insurance departments insist that these statements agree with the special-purpose statements included in the Convention Blank, as the uniform report filed with the state insurance departments is called. These statements are not based on the going concern assumption. They are built around a legal framework rather than double entry accounting. Unfortunately, since 1951 they have been made to look almost like the statements of commercial and industrial firms but are, in fact, quite different.

Several groups[1] have recently criticized these statements. Few of them, however, seem to have a clear understanding of the reasons for the

---

[1]Financial analysts are so concerned about acquisition costs and other items charged directly to expense by life insurance companies that they make their own rule of thumb adjustments to book values and earnings for the "value of insurance in force." For other criticisms by this group, see "Sub-committee Report on Life Insurance Company Annual Reports," special advance mailing to the membership by Financial Analysts Federation, December, 1963.

The Securities and Exchange Commission issued a proposed Article 7-A to Regulation S-X on August 20, 1962, requiring changes in the financial statements portion of life insurance company registrations under the Securities Act of 1933. So many protests and suggestions were filed that no further action has been taken. The Securities and Exchange Commission has asked Congress for extended authority over annual reports and other

differences between the statements of commercial and industrial firms which follow generally accepted accounting principles and the statements of life insurance companies, or to have pin-pointed precisely what those differences are.

---

aspects of stockholder interest in life insurance companies and devoted pages 77-82 of its 1963 Special Study on Securities Markets to life insurance companies.

The American Institute of Certified Public Accountants is deeply concerned about the type of certificate a CPA may give an insurance company. Life insurance companies were included in the provisions of Paragraph 38 of Statement on Auditing Procedure 32 in the fall of 1962 (now included in Chapter 10 of Statement on Auditing Procedure 33: Auditing Standards and Procedures, issued in December, 1963). That statement requires a disclaimer or qualification of opinion which calls the attention of the reader to departures from generally accepted accounting principles. Life insurance officials contend that they were not given sufficient opportunity to discuss their problems with the accounting profession prior to issuance of that statement, and joint meetings are now being held. See Richard C. Lytle, "Audit Reports on Insurance Companies," Journal of Accountancy, V. 117, No. 1 (January, 1964) 75, for a recommended interim wording of the certificate containing a brief summary of primary differences between life insurance statements and the requirements of generally accepted principles.

The 1959 Revenue Act brought the entire operations of life insurance companies into the computation of Federal income taxes for the first time. Tax specialists agree that an understanding of the differences between insurance accounting and generally accepted accounting on the part of revenue agents and the insurance company representatives who work with them is sorely needed.

The market prices of life insurance company stocks have risen many times faster than the prices of most other stocks in recent years. Although both Standard and Poor's 500 Stock Index and Best's Life Insurance Index are designed to measure price movement of actively traded stocks and both use 1941-1943 prices as a base of 10, Best's Life Insurance Index was 441.4 on May 31, 1964, compared to 85.4 for Standard and Poor's 500 Stocks. It may be that one of the reasons for this rise is that investors either ignore the financial statements of life insurance companies because they do not contain the information included in the reports of other companies, or else grossly exaggerate the effect of the conservatism which is built into life insurance company statements.

Many critics of life insurance company financial statements call attention to the fact that the life insurance industry is now the largest industry in the United States in terms of total assets. There has been a vast increase in the number of stock life insurance companies during the past ten years. At least a few of these companies have been promotional in nature in the sense that the organizers have made a quick profit at the expense of someone else. The Convention Blank statements do not contain all of the information needed to identify these firms.

This study attempts to identify those differences and the reasons for them. It also attempts to find the principal problems that life insurance companies would face if they attempted to extend and revise the Convention Blank statements so as to conform with the generally accepted accounting principles followed by other firms and makes a limited test of the materiality of such revisions.

Method of approach

The differences between insurance company financial statements and the statements of commercial and industrial firms which follow generally accepted accounting principles stem from the assumptions and frameworks upon which each set is built. This study accordingly takes two steps designed to provide a better understanding of these underlying concepts.

First, a brief comparison is made of the contrasts in the historical development of the basic structures of both systems of reporting and the basic philosophies underlying them. This review comprises Chapter II. Every effort is made to cut through the detail which is common to each system so as to concentrate on the fundamental underlying structures.

The second step is an attempt to adjust the statements of twenty-two life insurance companies to conform with generally accepted accounting principles. Plunging directly into the Convention Blank in this way and actually trying to make the conversions is the most effective way of identifying the precise differences. It is similar to the laboratory approach of the natural sciences.

The adjustment process is handled in two phases. In the first, six Nebraska domestic companies are analyzed in detail for ten or more

years each.[1] A regular accounting worksheet is prepared for each company for each year. These worksheets are then used to prepare the extended and revised financial statements which are presented in Chapter IV.

The detailed analysis of these six companies covered a total of sixty-six years, so sixty-six individual sets of detailed worksheets were prepared. As the worksheets were extended, each account was scrutinized for conformance with generally accepted accounting principles and, subject to the limitations stipulated later in this chapter, appropriate adjustments were devised in each instance where the Convention Blank figure did not conform with these principles. These worksheets verify the techniques used in computing the adjustments and insure that no major items are overlooked. The worksheet of Company F for 1962 is reproduced as Appendix II so that the exact procedure can be seen.

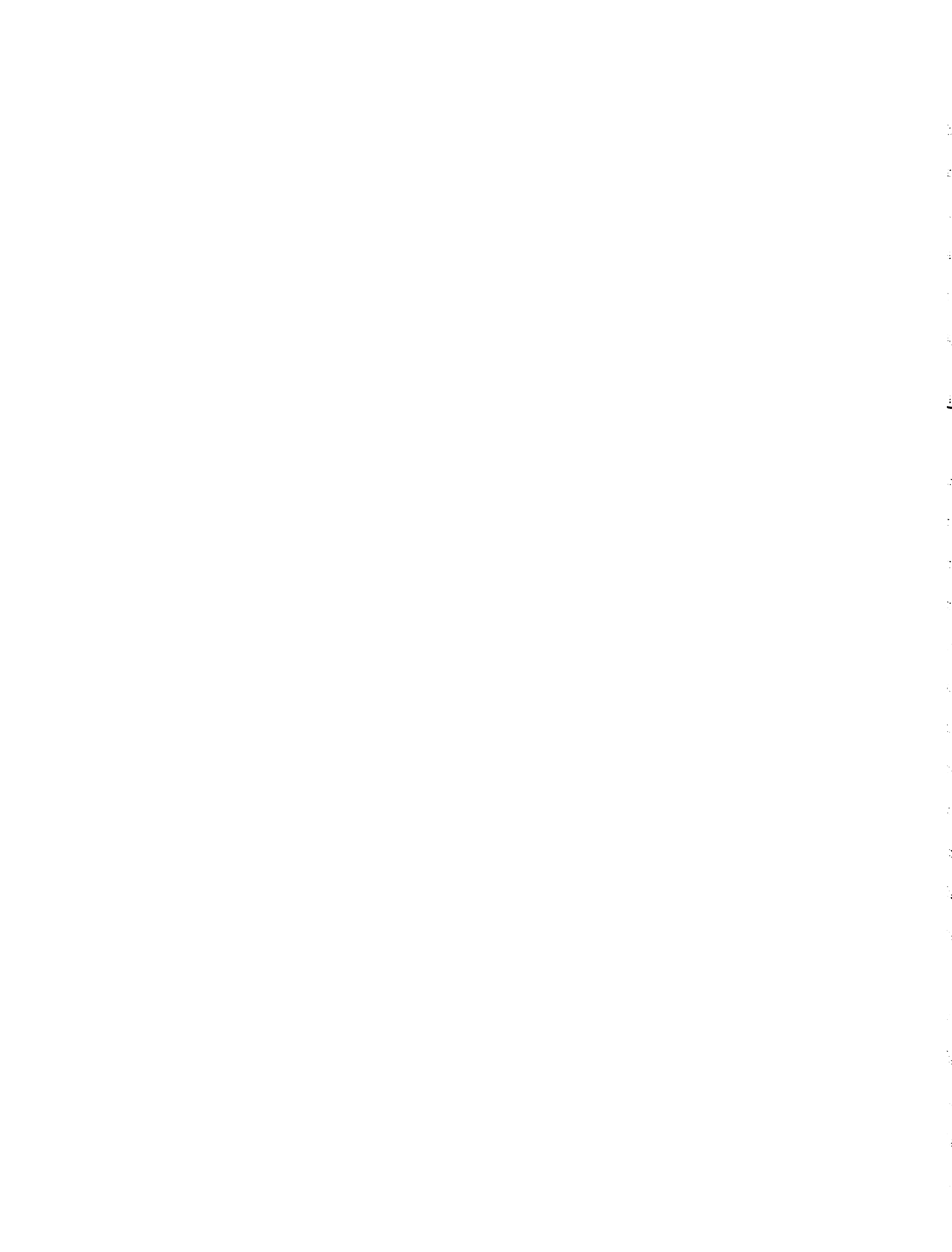
No new types of adjustments were uncovered in the analysis of the sixth company even though it is the largest of the six. Further detailed analysis would probably uncover little more than additional examples of the basic differences.

The analysis of six firms is not enough, however, to establish the materiality of the adjustments required. This materiality is tested by applying an abbreviated analysis to the remaining Nebraska stock companies[2] and to ten large national stock companies. Worksheets are not prepared.

---

[1]With the exception of Company A which was organized in 1954. Company D was organized in 1946 so it is analyzed for all seventeen years of its existence through 1962. The other four companies are analyzed for ten years.

[2]Excluding those which are so inactive or so new as to provide no base for significant study.



Instead, the adjustments which were worked out in the detailed analyses are applied directly to the Convention Blank figures, using a reconciliation schedule for control. This reconciliation, which shows the Convention Blank earnings and the revised earnings, is presented for each company subjected to the abbreviated analysis in Chapter V. A schedule of the individual adjustments is also included.

Nature of the adjustments required

Some indication of the severity of the problem faced by life insurance companies in preparing acceptable reports to stockholders can be grasped by examining briefly the nature of the adjustments which are required in order to make their statements conform with generally accepted accounting principles. These adjustments are divided into six broad groups for analytical purposes. These groups, and each of the individual adjustments within each, are tabulated in the "Location of Discussion of Adjustments" following the table of contents. Reference to that tabulation will indicate the specific items involved. Each group is discussed, and illustrated with an explanation of those individual adjustments which pertain to several companies, in Chapter III. The remaining adjustments are discussed in Chapters IV and V in connection with the analysis of the companies to which they pertain.

The Group I adjustments are the easiest to make because the information for them is tabulated in the detailed schedules in the Convention Blank. They are also the most revealing of the nature of insurance accounting. As will be established in Chapter II, the balance sheet in the Convention Blank is really just an elaborate formula for the computation of legal surplus. Only those assets which are qualified as legal investments of

policyholder reserves may be included. All other assets must be excluded. In general, the assets which qualify are those which are readily salable if needed to meet policyholder claims. Such things as balances owed to the company by agents do not qualify, so must be classed as "non-admitted" and excluded from the Convention Blank balance sheet. Interestingly, agents' credit balances must be separated from the debit balances. These credit balances are left in the liabilities even though the debit balances are eliminated from assets. This is indicative of a philosophy of conservatism which runs throughout the Convention Blank--include every possible liability but exclude all assets except those which are clearly salable at or above the value at which they are included. The Group V adjustments are similar to Group I, but deal with fixed assets. These two groups of adjustments restore the non-admitted assets to the balance sheet.

Corporation stocks and certain other investments are carried at market value in the Convention Blank. These assets are returned to cost, or cost adjusted for amortization of premium or discount, in the Group II adjustments.

The Group III adjustments are used to demonstrate the accepted accounting technique for providing for losses which experience has shown exist but which cannot be specifically identified at the time the statements are prepared. For example, some of the agents' debit balances will undoubtedly not be collected. Ten per cent of these balances are arbitrarily set up as a provision for loss.

The most difficult group of adjustments is Group IV. Revenue is received from insurance policies over a period of many years, commonly a person's lifetime. Most of the expenses in connection with a policy are incurred during the first year. Commercial accountants would strive for a

realistic matching of revenue and costs by charging the direct acquisition costs of a policy to an asset account and amortizing that cost against revenue when realized. Insurance companies take a different approach. They have developed several "modified preliminary term" plans for the computation of the liability for policyholder reserves which permit a smaller than normal reserve to be established at the end of the first policy year and then gradually bring the reserve up to the normal amount over a period of years. The same surplus is obtained as would result from establishment of an asset for the same amount as the reduction of the reserve, so the needs of the regulatory authorities are served.

Under generally accepted accounting principles, it is not permissible to compensate for omission of an asset[1] by understating a liability. An attempt is therefore made to adjust the statements so as to capitalize the acquisition costs and amortize them. In the case of life insurance policies, the specific adjustment is completely arbitrary, consisting merely of capitalizing first-year commissions and amortizing them over the five-year select mortality period, but effectively demonstrates differences between insurance concepts and generally accepted accounting principles, and provides a sufficient test of the significance of the adjustment.

Limitations

Several limitations were placed on the research for this study, but only the most important are mentioned here. Others are discussed in detail at the point where they have a bearing on analysis.

---

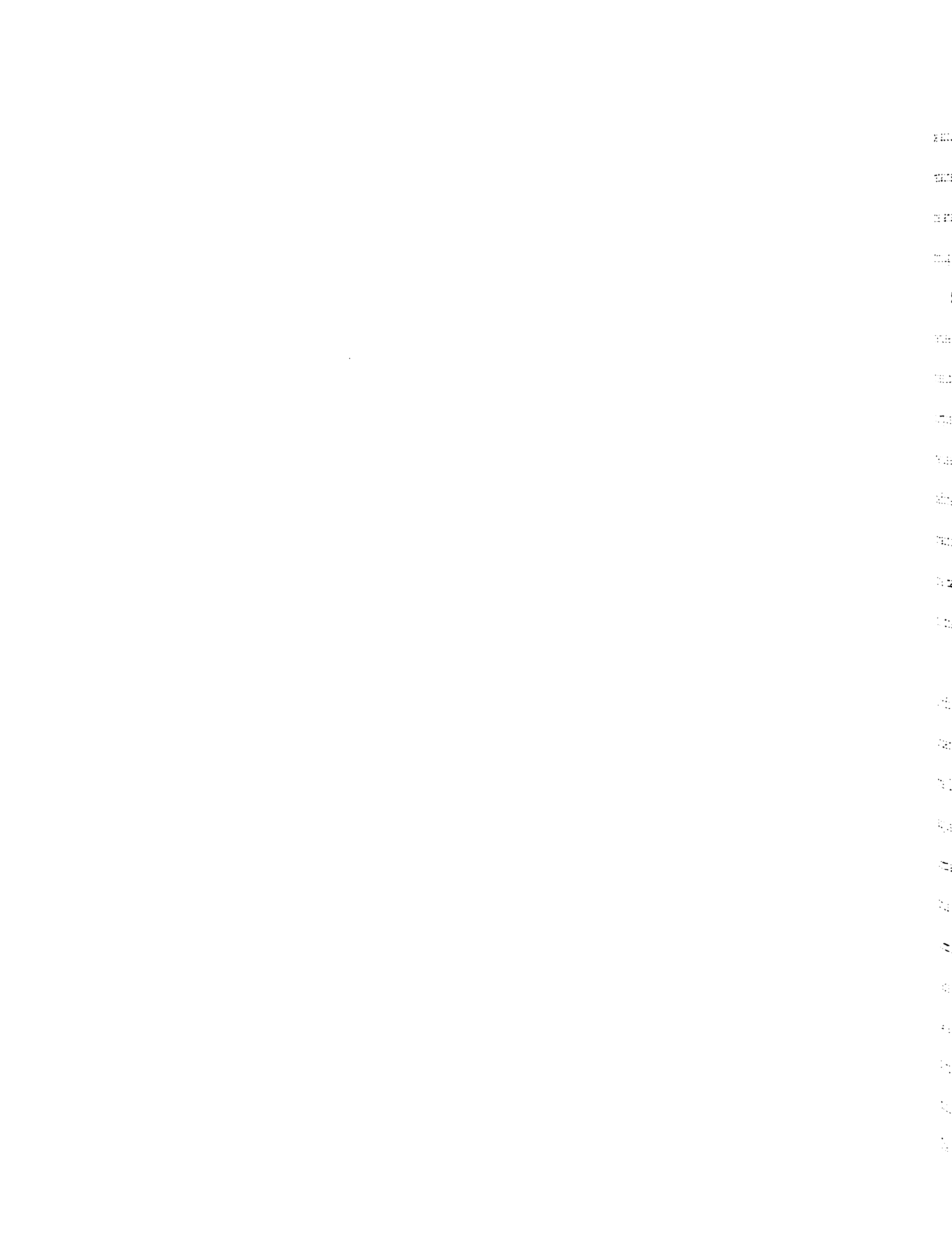
[1]It is important to note that the concept of an asset might be quite different in insurance accounting than it is in ordinary accounting, so insurance officials might not believe that an asset is omitted.

A fundamental point which must be clearly understood is that it is assumed that the Convention Blank provides the state insurance departments with precisely the information they need set forth in the format which is easiest for them to use. No changes of any kind are considered regarding the form or content of the Convention Blank. The objective of this study is to understand why and how the regulatory statements differ from the statements of commercial and industrial firms and to test the significance of these differences from the point of view of stockholders and other public users of published statements.

The companies analyzed are all stock companies with one exception. Company E is a mutual company. It is included in order to demonstrate that mutuals could adopt the recommendations made in this study without difficulty should they find them useful.

Before the Convention Blank statements could be adjusted to conform with accepted accounting principles, new financial statements had to be designed. These statements went through several extensive revisions but even as finally adopted are in no way presented as the best statements which could be adopted by the industry. They are research tools only, and admittedly are both technically imperfect and possibly too complicated for adoption in present form.

All of the financial statements and information for the adjustments were obtained from the Convention Blanks and the examiners' reports on file in the Nebraska State Insurance Department. The adjustments are, therefore, limited to the data available in those reports plus a few arbitrary estimates which are believed reasonable and which could probably



be accurately determined by the companies. The Nebraska Insurance Department retains the Convention Blanks of foreign companies for only five years, so the analysis of the ten national companies is confined to the years 1958 through 1962.

Since some of the adjustments are based on arbitrary assumptions, the revised financial statements are not as precise in detail as would be possible in practice. This is not a matter of serious concern because the purpose of this part of the study is to test the feasibility of making revised statements and to determine what specific problems must be solved before meaningful revised and extended statements could be prepared in practice. The assumptions are realistic enough to permit a fair test of the materiality and significance of these extended statements as compared to the statements in the Convention Blank.

Even though the revised and extended statements are labeled "in conformance with generally accepted accounting principles," it must be understood that certain principles could not be fully applied because of the limitations on the sources of data. Minor omissions of desirable adjustments are mentioned from time to time in the discussion of the company analyses, but two are so important as to require underscoring at this point. One is that the adjustment for first-year life insurance commissions is not only arbitrary, but is the same for all companies regardless of the reserve valuation plan followed. A proper adjustment would have to take cognizance of the method of reserve valuation used. Only that portion of direct acquisition costs not recovered through use of one of the modified preliminary term reserve valuation methods should be capitalized. The importance of the reserve valuation method is clearly demonstrated in

the study of those Nebraska companies which have been organized only a short time. These companies are discussed in the first portion of Chapter V.

The other major area which is not brought up to the minimum requirements of generally accepted accounting principles concerns Federal income taxes. Half of the underwriting profits of life insurance companies are not taxed until distributed to stockholders or until certain maximums are reached. The amount of earnings so deferred must be credited to a special Phase III "policyholder surplus,"[1] account for tax purposes. The Convention Blank does not even ask the company to state the amount of profit deferred from taxation in this account. Without access to the tax returns, it is, therefore, impossible to estimate the amount of tax which may eventually be payable on this income. Furthermore, it is impossible to test whether this tax could be computed accurately enough under the three phase method required of life insurance companies to make formal recognition in the accounts practical, or if footnote disclosure is the best that can be achieved.

Without access to the tax returns, it is similarly impossible to estimate the amount of tax which will eventually be paid (or be reduced, as the case may be) on the change in income which results from the adjustments given effect in preparing the revised and extended financial statements. These statements cannot truly be said to conform with generally accepted accounting principles until all of these tax factors are adequately disclosed.

---

[1]"Policyholder surplus" is used in a specialized sense in the Internal Revenue Code to refer to this income which is deferred from taxation. This is not the same as the meaning ascribed to the term in state insurance statutes.

CHAPTER II

COMPARISON OF THE HISTORICAL DEVELOPMENT OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND THE LIFE INSURANCE CONVENTION BLANK

Life insurance company financial statements are special purpose reports. They are based upon different postulates, are built upon a different framework, and are designed to serve different purposes than statements prepared in accordance with "generally accepted accounting principles." The statements of life insurance companies are not based upon the going concern postulate. They are built around a legal framework designed to provide the data which the state insurance departments have asked for to help them fulfil their statutory obligations to the policyholder and the public. Consequently, financial statements of life insurance companies are policyholder oriented rather than stockholder oriented, and are more concerned with valuation than with allocation.

Both general commercial financial statements and the special reports used by life insurance companies have developed gradually in response to the needs of the users of the statements. A sound starting point in obtaining an understanding of the differences between the two types of statements and the reasons for these differences is to examine the process by which each has developed. This chapter attempts to do this, but is intentionally limited to the most important factors in the development of the basic framework underlying the two systems of financial reports. The important

differences between the reports stem from fundamental differences in these basic frameworks so it is desirable to focus attention on them.

"Generally accepted accounting principles" involve a concept which must be understood rather than defined. A sizeable portion of the discussion of traditional accounting in this chapter is accordingly devoted to the development of this concept and its meaning. Particular emphasis is placed on the research programs of the professional accounting organizations in an effort to indicate why no attempt is made to list specific generally accepted principles in this study.

Most of the material in this chapter is based on secondary sources. The purpose of the chapter is to contrast the known factors in the development of the two systems of financial reports rather than to ferret out previously undiscovered items. Much of the general material on the development of statements based on generally accepted accounting principles which is not footnoted to other sources is summarized from the several works by A. C. Littleton[1] and from Reed K. Storey's study,[2] which was published after most of the research for this dissertation was completed but which brings much of the recent material together in a form which permits easy contrast with the development of insurance reports. Similarly, part of the material

---

[1]The following were used extensively: Accounting Evolution to 1900 (New York: American Institute Publishing Co., Inc., 1933); Studies in The History of Accounting, joint ed. with B. S. Yamey (Homewood, Illinois: Richard D. Irwin, Inc., 1956); Essays on Accountancy (Urbana, Illinois: University of Illinois Press, 1961); and Accounting Theory: Continuity and Change, with V. K. Zimmerman (Englewood Cliffs, New Jersey: Prentice Hall, Inc., 1962)

[2]The Search for Accounting Principles: Today's Problems in Perspective (New York: American Institute of Certified Public Accountants, Inc., 1964). A condensed version appears in the Journal of Accountancy, V. 117, No. 6 (June, 1964) p. 47-55 under the title "Accounting Principles: AAA and AICPA."

on the development of life insurance company statements prior to the 1951 revision of the Convention Blank is summarized from an unpublished dissertation by Sterling Surrey at the University of Pennsylvania in 1950, entitled The Development of the Convention Form of Life Insurance Statement, and from the proceedings of the National Association of Insurance Commissioners.

THE DEVELOPMENT OF STATEMENTS WHICH CONFORM WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Accounting as we know it today has developed through three stages: (1) record keeping, (2) bookkeeping, and (3) accounting.[1] The origin of double entry is obscure, but it ushered in the bookkeeping stage. The bookkeeping stage gradually gave way to the accounting stage as the double entry bookkeeping which was developed by the Italian merchants of the thirteenth and fourteenth centuries was blended with the stewardship reports developed during feudal times in England. The gradual process by which this blending took place is traced in the next few pages.

The Framework

Double entry bookkeeping

Double entry bookkeeping is an analytical model in which each transaction is analyzed from two points of view. One point of view is that of amounts expended. The other is that of where the funds or purchasing power came from. Naturally, since the same transaction is involved, the totals recorded from each point of view are the same. This is the reason that

---

[1]This concept is discussed by James Don Edwards in "Early Bookkeeping and Its Development into Accounting," Business History Review, V. 34 (Winter, 1960) 446-458.

double entry bookkeeping has been called a self-proving system. Even more important, it is the feature which permits complete integration of the real and nominal accounts.

The idea of double entry undoubtedly arose somewhere back in the record keeping stage. Very possibly it was in connection with the early Roman contract of _expensilatio_.[1] Whether or not this is the origin of the idea is immaterial because the dark ages were really dark as far as accounting is concerned. Bookkeepers had to start afresh after this period without having inherited the achievements of their classical forebearers. The first, and best known, treatise dealing with double entry bookkeeping is part of a book on mathematics written in 1494, just two years after Columbus discovered America, by Luca Paciolo. The system which he describes was already highly developed and widely used by the Northern Italian merchants and bankers. Paciolo's objective was to collect material on mathematics and bookkeeping and put it in the hands of the Italian people, hoping that they would use it to improve their lives.

Accounting has been put to uses never dreamed of by Paciolo, but the double entry bookkeeping on which it rests has remained unchanged. As Brown and Johnston point out in their recent book on Paciolo, "most of the accounting methodology suggested in the treatise . . . are as applicable today as they were in the fifteenth century."[2]

---

[1] C. A. Smith, "Speculations on Roman Influences on the Theory of Double Entry Bookkeeping," _Accounting Research_, V. 5 (1954) 335-42.

[2] R. Gene Brown and Kenneth S. Johnston, _Paciolo on Accounting_ (New York: McGraw-Hill Book Company, Inc., 1963) 8.

It is generally conceded that the "cross-entries" which bankers maintained contributed to the development of double entry bookkeeping, but the essential ingredient was need on the part of merchants. If Florence Edler de Roover's description of pre-double entry partnerships is accurate,[1] it is easy to understand why these firms welcomed a system which reflects the source of all funds received on one hand and the specific assets those funds were invested in on the other. She points out that there were two principal types of contract, but both involved a traveling partner and an investing partner. The traveling partner might be involved in several partnerships on a single trip, each with a different investing partner. Profits were computed at the end of the venture, although there is some evidence that settlement was sometimes made before all of the items were disposed of.

Many of the large merchandising houses were also bankers. Littleton and Zimmerman, in fact, characterize the early double entry records as those of the Italian banker-traders.[2] The need for keeping track of both the sources of funds and the amounts expended for specific items must have become extremely acute when both the traveling partner and the merchant-banker who acted as the investing partner were involved in several ventures at the same time. The establishment of branch offices and similar complications of organization undoubtedly furthered the need for, and demonstrated the effectiveness of, the double entry system.

---

[1]"Partnership Accounts in Twelfth Century Genoa," in A. C. Littleton and B. S. Yamey (ed.) Studies in the History of Accounting (Homewood, Illinois: Richard D. Irwin, Inc., 1956) 86-90.

[2]Accounting Theory: Continuity and Change (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1962).

The system described by Paciolo did not provide for financial statements. Since the ledger was accessible to all of the members of the venture, the profit and loss summary account served as an income statement. Before any entries were made in the records they were often presented to government officials for authentication. Thereafter these books were admissible as legal evidence.

Balance sheets were not a part of the system. The closest thing to a balance sheet was the balance account. This account was used when the balances were transferred to a new bound ledger, and was really nothing more than a post-closing trial balance.

The real contribution.--The recording of transactions twice, each from a different point of view, is the basic mechanic of double entry bookkeeping, but it is not the real contribution of the method. The real contribution lies in the integration of the real and nominal accounts. This is the foundation upon which present-day general accounting is based. Its significance is emphasized by Littleton with the observation that "here, for the first time, was a method of systematically and continuously recording the interaction of capital on income and of income on capital, thus making it possible to observe the separateness and the interrelation of finance and operations."[1] The following evaluation is made by Littleton and Zimmerman: "The significance of the accomplishment of the integration of real and nominal accounts far surpasses every other single aspect of accounting development."[2] They label the Italian double entry system "capital-income" accounting to emphasize this integration.

---

[1]"Variety in the Concept of Income," *New York Certified Public Accountant* V. 23, No. 7 (July, 1953) 420. Reproduced in *Essays on Accountancy* (Urbana, Illinois: University of Illinois Press, 1961) 288.

[2]*Accounting Theory: Continuity and Change*, p. 47.

English stewardship reports

Most of the countries of Northern Europe were able to get by with memorandum single entry records until the Italian double entry method was made available through the several translations of Paciolo's book which appeared shortly after its original publication.[1] The English had, however, developed a system of stewardship reports which were especially adapted to the feudal organization which came into being following the Norman invasion. This system was primarily one of agency reports rather than the capital-income, proprietorship accounting under the Italian system.

Vestiges of the English agency system can be seen in some of our present-day legal requirements for fiduciary accounting. The principal characteristic of the system was that the party reporting would charge himself with the items he became responsible for and discharge himself in the record for every release from responsibility. The report was not necessarily in monetary terms. For example, the records kept at each station in one of the landed estates (granary, mill, bakery, dining hall, etc.) might indicate (1) materials received, in quantity but not money price, (2) product converted (either forwarded to the next station or consumed), and (3) material or product left, if any.[2]

Two aspects of these reports are particularly significant for this study. First, these were reports by agents who were acting for someone else. The reports are of stewardship, or accountability, concerning

---

[1]Raymond de Roover includes a comprehensive summary of the bookkeeping of these countries in "The Development of Accounting Prior to Luca Pacioli According to the Account-Books of Medieval Merchants," in A. C. Littleton and B. S. Yamey (ed.) Studies in the History of Accounting, pp. 114-174.

[2]Littleton and Zimmerman, p. 23.

discharge of responsibility for someone else's property. Corporate management occupies a position with some similarities to such agency. Second, no specific records were apparently required. The important thing was the report and it was up to the individual to keep records which would permit him to properly complete the report. This is essentially true of the Convention Blank used by insurance companies today.

Blending

The blending of these two concepts--the Italian "capital-income" accounting with its emphasis on items which affected the proprietor either favorably or unfavorably, implemented with a double entry bookkeeping procedure which permits complete integration of the real and nominal accounts; and the English financial reports emphasizing stewardship and accountability--produced the basic framework upon which modern commercial and industrial accounting is built. Our records are double entry but are summarized into financial statements emphasizing accountability and stewardship.

It must be emphasized that accounting has developed far beyond a mere blending of the Italian bookkeeping system with the English reports, but the basic framework has not changed. The development of accounting has been through recognizing previously undetected usefulnesses, by adding to the services performed through the basic structure, through refinement of theory, and by devising more efficient ways of carrying out the basic procedure.

Building On To the Framework

Although accounting developed primarily as a means of providing operating management (owners in the old days) with information regarding

their own past actions,[1] the principles which are referred to in the standard CPA certificate are largely oriented toward statements prepared for outsiders. Mention of just a few of the many influences upon the development of accounting after the merging of the Italian and English systems is sufficient to show how this came about.

Periodicity and the accrual, or revenue, basis of accounting

Little attention was paid to fixed assets in the bookkeeping for the Italian foreign trading ventures. The books were closed at or near the end of the venture and profit was computed at that time. Consequently, an accurate profit computation was obtained if the asset account was debited for the cost of assets purchased and credited for the proceeds of sale. The balance prior to sale was the amount invested in the asset, and the balance after sale was the net cost (or profit) of using the asset. If settlement was made before all assets were disposed of, these assets were valued at expected realizeable value since liquidation was intended. Fixed assets were thus placed on the books as an adjusting entry for inventory of goods to be sold.

Not all businesses were ventures for a limited period of time. In continuing businesses, partners wished to make periodic settlement instead of waiting until the partnership was dissolved many years hence to divide profits. First attempts at this probably consisted of hypothetical liquidations, but this soon gave way to simply dividing profits on the transactions

---

[1] A. C. Littleton, "Principles Under Challenge," *New York Certified Public Accountant*, V. 24 (January, 1954) 26. Reproduced in *Essays on Accountancy*, p. 407.

which were complete. This was apparently done at irregular intervals whenever the partners chose to make a settlement. Expenditures for incomplete transactions were simply left in the asset accounts, and were carried forward to a new ledger through use of the balance account referred to previously. While theory was not discussed in those days, here was the going concern postulate in its basic form.

Irregular settlement computations gradually gave way to regular annual closing of the records, especially for merchandising firms where the annual period was a natural operating cycle. An annual period has been universally adopted today, the only concession being that many firms use a fiscal year which ends on dates other than December 31.

As soon as the practice of opening a new ledger each year was adopted, the accrual, or revenue, basis of accounting became readily possible. In fifteenth century Italy this was achieved by holding the revenue records open for awhile. Transactions during the first part of the new year were entered in whichever set of books was most appropriate. After a time into the new year, all transactions were entered in the new set and the old set was closed.[1] This method produced reliable earnings data and was satisfactory so long as the balance account remained simply a method of transferring the accounts to the next ledger.

A complete cycle of statement emphasis

The settlement of partnership accounts may have caused the first financial statements to be prepared. Since only one person could keep the

---

[1]Wilmer Green, History and Survey of Accountancy (Brooklyn, New York: Standard Text Press, 1930) 105.

books, copies of the profit and loss summary account and the balance account were likely given to the other partners. A columnar form was worked out which permitted revaluation of any items necessary in order to make a proper settlement.[1] This form of statement eventually became the accountant's worksheet. It made the preparation of adjusting entries easy to handle and may have contributed to the development of these entries as a method vastly superior to holding the books open. It permitted accurate balance account figures as of the end of the period.

Even though English translations of Paciolo's book were available, the Italian system was apparently brought to England by young merchants who were sent to Italy or the Low Countries to study. They brought double entry bookkeeping back to their businesses in England, but the English legal system was used to working with financial statements which were reports of stewardship. The net result was that, even though less satisfactory in several respects, the balance sheet replaced the charge and discharge statement as a report of stewardship and changed places with profit and loss as the most important statement. To some extent the profit and loss statement became the proof of the change in the balance sheets from one year to the next.

The advent of the corporation did much to emphasize the balance sheet in England. Although limited companies had been formed by special charter as early as the East India Company in 1600, the British Companies Act of 1862, and the less complete act of 1855, constitute the first nationwide recognition of the principle of freedom of incorporation with limited

---

[1] Littleton, Accounting Evolution to 1900, p. 137.

liability and, along with it, direct accountability to shareholders. The act required that the accounts be examined and the correctness of the balance sheet ascertained by one or more auditors. No mention was made of a trading or profit and loss account.[1]

The balance sheets submitted by the English companies were apparently highly condensed and void of meaningful detail. Prior to World War I, it was not necessary for management to render detailed reports because the firms were able to obtain the capital they needed without them. Two "old wives' tales" were often used to argue against detailed statements, particularly anything having to do with profits--(1) in good times, no one cares and (2) in poor times they give too much information to competition.[2] Littleton and Zimmerman place the reasons on a loftier plane by suggesting that the prominence of the balance sheet during this period was apparently encouraged by ideas about accountability derived from the landed estates of feudal days whereas privacy of income data reflects an extension of the ideas of the classical economists about free enterprise and the controlling force of competition.[3]

Balance sheet emphasis in the United States during this period stemmed from other factors. With the exception of the railroads, which copied the English reporting requirements to a large extent, enterprise did not draw significant amounts of capital from public sale of securities. Only

---

[1]Maurice E. Peloubet, "The Historical Background of Accounting," in Morton Backer (ed.) Handbook of Modern Accounting Theory (New York: Prentice-Hall, Inc., 1955) 21.

[2]Nicholas A. H. Stacey, English Accountancy, A Study in Social and Economic History, 1800-1954. (London: Gee and Company, Ltd., 1954) 60.

[3]Littleton and Zimmerman, p. 95.

thirty-seven industrial stocks were listed on the New York Stock Exchange as late as 1897.[1] Short-term bank loans developed, with the encouragement of the bankers, as the primary outside source of working capital. Consequently, the first outsiders to receive financial statements in this country were bankers. They looked on the balance sheet as a clue to a borrower's probable ability to repay short-term loans. This ability was thought to be more directly related to the conversion of inventory into cash than to the earning of a periodic profit.[2]

The price break and inventory depression of 1920-21 led to the adoption of a policy of financing through stock issues instead of through short-term borrowings. This in turn directed attention to earnings computations and marks the point from which the income statement took precedence over the balance sheet. Even short-term credit grantors began to realize that loans are ordinarily repaid out of normal operations and profits. Liquidation was finally recognized as a last ditch defense.

This does not mean that the idea of stewardship or accountability by management was abandoned. Rather, it was a recognition that management exercises a multiple stewardship, operating as well as financial.[3] The income statement provides a measure of earnings at the point where they become subject to management decision concerning their disposition. Earnings are one of the sources of funds for which management must account

---

[1]George O. May, Financial Accounting (New York: The Macmillan Company, 1943) 51.

[2]Littleton and Zimmerman, p. 92-95.

[3]See A. C. Littleton, Structure of Accounting Theory (Urbana, Illinois: American Accounting Association, 1953) 79-81 for a discussion of shortcomings of traditional financial statements as reports of stewardship.

and are also an indication of how well management has met its operating stewardship obligation by putting funds to work to create earning power.

As often happens, once the income statement received attention it was over-emphasized. Today, the balance sheet is coming back in for attention, but not from the liquidation straight-jacket viewpoint of the nineteenth century. It is gaining recognition as the foundation for the computation of earning power rather than as either extreme of (1) the only important statement or (2) mere proof of the accuracy of the earnings statement. Furthermore, it is now recognized that income as a measure of performance must be compared against investment in the firm.[1]

A complete cycle has thus been made. Early Italian accounting was almost entirely income oriented. Emphasis gradually changed to the balance sheet but starting in the 1920's the income statement again came into prominence. In very recent years the balance sheet has been brought back in for more attention. It may be that a lasting equilibrium of emphasis between the two primary statements has been reached.

Development of Generally Accepted Accounting Principles

Reports to stockholders prior to 1900

As financing moved from short-term loans to sale of long-term securities, industrial accounting took on new significance. The New York Stock Exchange started trying to improve the quality and quantity of data made available to stockholders as early as the Civil War, but without much success. Louis H. Rappaport recently characterized the period as one in which the financial affairs of a business were regarded as highly confidential

---

[1]R. J. Chambers, "Function of the Balance Sheet," Chartered Accountant in Australia, V. 27 (April, 1957)

and any suggestion that they be made available to outsiders--among whom public stockholders were included--was considered presumptuous.[1] This sounds remarkably like the situation in England noted previously. As will be discussed in the next part of this chapter, insurance companies were filing detailed reports of assets during this period, but were just as reluctant to reveal operating data as were commercial and industrial firms.

Rappaport cites two examples which may not only help visualize the improvement which has taken place in reporting to stockholders during the twentieth century, but should help keep some of the early shortcomings of the uniform insurance report in perspective. In 1866, just five years before the National Association of Insurance Commissioners was formed, the Delaware, Lockawanna & Western Railroad Company replied to a request for information by the Stock Exchange by stating that it ". . . makes no reports and publishes no statements and has not done anything of the kind for the past five years."

In 1892, at the time when the National Association of Insurance Commissioners was debating the inclusion of a Gain and Loss Exhibit in the annual insurance report, one of the footnotes to the balance sheet submitted in the listing application of General Electric Company predicted that a large profit might be expected from certain bonds that were carried in the statement at 70 per cent of par value. Another footnote assured the reader that the inventory had been taken in the usual way at <u>less than cost</u>. (emphasis added). A third footnote stated that the large amounts expended for patents had all been charged to expense.

---

[1]"Forces Influencing Accounting: The Stock Exchanges," <u>Lybrand Journal</u> V. 44, No. 1 (1963) 45.

By 1895, balance sheets were required with listing applications, and by 1899 annual reports to stockholders were required.[1]

Action by the New York Stock Exchange

The Exchange was stirred to determined action by publication of a series of articles by a Professor William Z. Ripley in the *Atlantic Monthly* in 1926 in which he was extremely critical of the information furnished, or not furnished, to corporate stockholders. Mr. J. M. B. Hoxsey was appointed the first executive assistant to the Committee on Stock List. He obtained the services of George O. May, senior partner of Price Waterhouse and Co. as a consultant and in 1930 was instrumental in forming a joint committee with the American Institute of Accountants[2] with Mr. May as chairman. Correspondence between the Exchange and the Institute committee was fruitful and eventually was published as a pamphlet entitled *Audits of Corporate Accounts*.[3] This document is a milestone in the history of accountancy in the United States and marks the start of a concentrated effort to set forth accounting principles pertaining to financial statements for stockholders and others outside the firm.

First use and meaning of the term "generally accepted accounting principles"

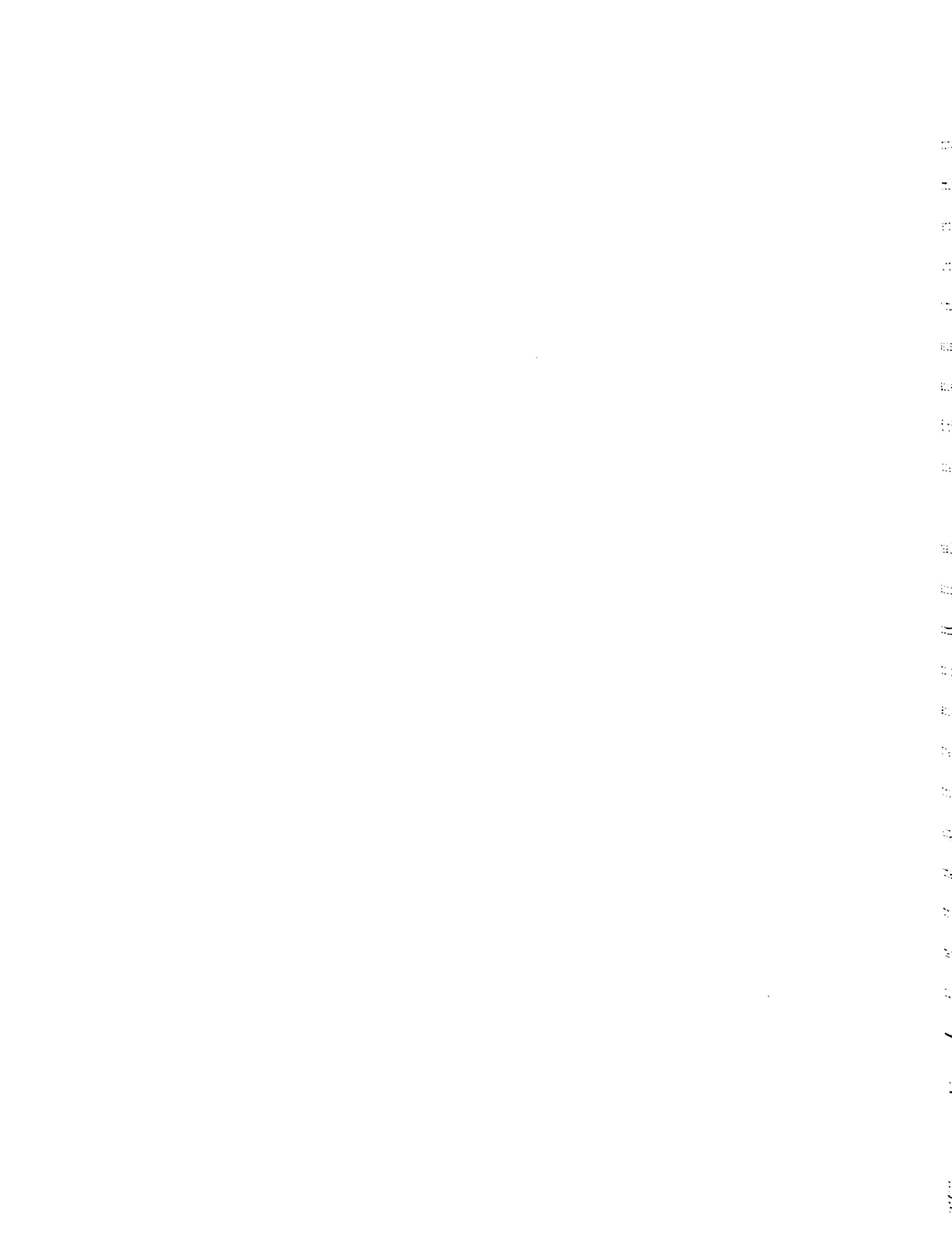
One of the particularly interesting developments in the correspondence between the Exchange and the American Institute was the use of the phrase

---

[1]Rappaport, p. 46.

[2]Now the American Institute of Certified Public Accountants.

[3]New York: American Institute of Accountants, 1934.



"principles of accounting." Early drafts used the word "practices" but terminology turned to such phrases as "practices or principles" and eventually became "principles." In later discussion, May was quick to point out that the committee had considered a principle as "a general law or rule adopted or professed as a guide to action; a settled ground or basis of conduct or practice."[1] He repeatedly emphasized the word "accepted" because it makes clear the essential point that the authority of the rules or principles on which accounting is based depends on acceptance.[2]

One of the recommendations of the joint committee was never fully realized but has provided the stimulus for much of the development of accounting theory since that time. Each company was to submit a fairly comprehensive summary of the methods and procedures it had adopted and was to follow them consistently or notify the Exchange of changes. The public accountant would certify whether the methods used were acceptable, whether they had been consistently followed, and whether the methods used were properly reflected in the statements.[3] In his Financial Accounting, May explains the intent of this provision was as a means by which (1) to make unequivocally clear the existence of a variety of methods and (2) to provide a procedure by which the variety could be curtailed and the best methods gradually made practically universal. He believed that if corporations were required to explain in detail the bases on which their financial

---

[1]"Principles of Accounting," The Journal of Accountancy, V. 64, No. 6 (December, 1937) 423. The definition was taken from the Oxford Dictionary.

[2]"Principles of Accounting," p. 24.

[3]Reed K. Storey, The Search for Accounting Principles: Today's Problems in Perspective (New York: American Institute of Certified Public Accountants, Inc., 1964) 14.

statements were made up the pressure of public opinion would gradually bring about the elimination of less desirable practices.[1]

The Securities and Exchange Commission

The cooperation between the New York Stock Exchange and the American Institute undoubtedly had a profound effect on the development of commercial and industrial accounting in another respect. The Securities and Exchange Commission was given authority to prescribe "the items or details to be shown in the balance sheet and earnings statement, and the methods to be followed in the preparation of accounts,"[2] for the companies subject to their jurisdiction. However, the Commission chose not to exercise this power. Instead, it sought cooperation from the accounting profession and, following the lead of the Exchange, endeavored to rely on accepted corporate accounting practice and on the competence of the independent accountants. Their basic position is well summarized in their twenty-ninth annual report as follows:

> In the area not covered by such rules (specific rulings by the Commission), the Commissions principal means of providing investors protection . . . is by requiring a certificate from an independent public accountant based on an audit . . . which expresses an opinion as to whether the financial statements are presented fairly in conformity with accounting principles and practices which are recognized as sound and which have gained general acceptance.

The Professional accounting associations

The term "accepted principles" has worried accountants from the time it was first used because they have difficulty stating what it means. It

---

[1]May, Financial Accounting, p. 41-42.

[2]Securities Act of 1933, Section 19(a). Similar language is found in the Securities Exchange Act of 1934.

is quite possible that the meaning today is not the same as the meaning ascribed to the term by the committee which first used it. Whether or not this is so is beyond the scope of this study, but it is important to distinguish the approaches taken by the two professional associations which have devoted substantial attention to the concept, and to ask what criteria insurance companies have to meet before accountants could properly certify that their statements are prepared in conformance with generally accepted principles.

The contributions by the professional associations have been carefully traced in the study by Reed K. Storey mentioned previously, so only those highlights which help explain the criteria which statements must meet in order to properly bear the label "generally accepted" need to be mentioned here.

According to Storey, "accounting, as it is practiced today, probably owes more to the decade of the thirties than to any other period after the development of double entry bookkeeping."[1] The two accounting organizations which have been most directly concerned with accounting principles pertaining to statements prepared for stockholders chose their respective approaches to the problem of identifying accounting principles and of setting guidelines for the practitioner during this period. One of the most significant contributions of the period was the acceptance of accounting as a process of cost allocation based on the matching of revenues and expenses.

Original approaches.--One of the first specific steps designed to help the practitioner, as well as the theoretitian, was a study by

---

[1]Storey, p. 19.

Messrs. Sanders, Hatfield and Moore.[1] The statement of principles resulting from this study was obtained from interviews, reviews of accounting literature, statutes, court decisions, and corporation reports. The final report consisted of a set of generalizations derived from accounting practice and was largely an uncritical acceptance of existing methods. It was, in short, a distillation of practice.

One of the chief benefits from the study came as a result of a misunderstanding of its purpose. Several extremely questionable practices were included in the list of procedures which were being used, and the report was severely criticized. Even though this criticism may not have been justified in view of the purpose of the report, the fact remains that for almost the first time a critical look was taken at many practices which were being followed.

The American Accounting Association, formerly the American Association of University Instructors in Accounting, published four statements on accounting principles with important matters elaborated upon in eight supplementary statements during the period from 1936 to 1957. The approach of the American Accounting Association might be characterized as searching for "what ought to be." Specifically, the Association believed that improvement in accounting and reporting practices could best be achieved by strengthening the over-all theoretical framework which supported accounting practice. The principles which they sought to identify were not

---

[1]Thomas H. Sanders, Henry Rand Hatfield and Underhill Moore, _A Statement of Accounting Principles_ (New York: The American Institute of Accountants, 1938). The study was sponsored by the Haskins and Sells Foundation. It was republished by the American Accounting Association in 1959.

descriptions of procedures but standards against which procedures might be judged. Between 1936 and 1957 the Association's pronouncements gradually evolved from a fairly general statement about a few items into a more or less comprehensive statement covering most of the important areas of accounting.[1] This does not mean that the Association's pronouncements were universally accepted, however. They were not intended to be since they were designed to set a level toward which practice could be raised. Furthermore, they were the work of committees. Criticism was, especially in the first statement, specifically invited with the hope that wide discussion would lead to a more comprehensive and improved formulation.

The American Institute of Certified Public Accountants took a different approach. Although seldom stated in the literature, many of the Institute's pronouncements partake of the nature of minimum requirements which must be met before a member can properly certify to the statements. Specific problem areas were dealt with rather than broad problems. The approach was primarily practical; the objective was to give immediate help to the practicing accountant faced with a problem. The Institute has had an important committee working on accounting principles since 1933. The first committee adopted six rules, the first five of which had been recommended in the correspondence with the New York Stock Exchange. A twenty-one man committee on Accounting Procedure was formed in 1938 and continued until 1959. This committee issued a series of 51 accounting research bulletins dealing with problems facing the accounting profession. Early in its

---

[1]Storey, p. 42.

career the committee discussed briefly the desirability of preparing a comprehensive statement of accounting principles that would be virtually all-inclusive, but this was quickly rejected. The approach taken was stated in the committee's first report as follows:[1]

> The present plan of the committee is to consider specific topics, first of all in relation to the existing state of practice, and to recommend, whenever possible, one or more alternative procedures as being definitely superior in its opinion to other procedures which have received a certain measure of recognition and, at the same time, to express itself adversely in regard to procedures which should in its opinion be regarded as unacceptable. In considering each case, particularly where alternative methods seem to possess substantial merit, it will aim to consider the conflict of considerations which make such a situation possible and thus gradually to prepare the way for further narrowing of choices.

In 1949 the Committee began a renewed effort to formulate a comprehensive statement of principles, but the project was soon abandoned in favor of the approach the committee had followed since its inception and the first 42 bulletins were combined into Accounting Research Bulletin 43.

In spite of the differences in philosophy and in the basic concepts and methods of approach, the two professional associations have three basic similarities in their original programs: (1) the two societies had exactly the same objective--the improvement of financial accounting and reporting practice by reducing the number of acceptable alternative procedures; (2) both saw financial accounting as essentially a process of cost and revenue allocation rather than as a process of asset and liability valuation; and (3) both looked upon accounting principles as being derived from accounting practice.[2]

---

[1]"History of the Accounting Procedure Committee--from the Final Report," The Journal of Accountancy, V. 108, No. 5 (November, 1959) 70-71.

[2]Storey, p. 41.

The different approaches of the two associations complemented each other in many respects. To some extent, the American Accounting Association set forth general goals and ideals while the American Institute laid down minimums representing the furthest deviation from the ideal which would be tolerated in specific instances. Storey gets at this by observing that the Institute's position was that accounting principles were a distillation of experience and that they were essentially conventions. The Association, by contrast, had considerably more of the flavor of "this is how accounting should be" and viewed principles as standards by which rules and procedures should be evaluated.

Not all of the Institute's bulletins were strictly minimum requirements, nor were all of the Association's releases restricted to broad standards. Procedural rules crept into the Association's statements and some of the Institute's bulletins made strong pleas for methods which the committee considered superior. Storey observes, however, that "(1) the committee on accounting procedure failed to make firm choices among alternative procedures, and (2) the committee was clearly reluctant to condemn widely used methods even though they were in conflict with its recommendations."[1] As a consequence, one of the problems plaguing the accounting profession and the business world today is a super-abundance of acceptable accounting practices. Storey notes that most of the questionable practices which were in evidence in the Sanders, Hatfield and Moore statement had completely disappeared by the late 1940's or early 1950's, but there has been an increase in the number of alternative methods and

---

[1]Storey, p. 49.

procedures which "have been able to squeeze past the minimum barriers and have been cloaked with the respectability inherent in 'general acceptance.'"[1]

The new research program of the AICPA.--It was against this background that the American Institute of Certified Public Accountants embarked upon a new research program. The old Accounting Procedure Committee rendered its final report in 1959 a few months after the new program got under way. Practitioners and others contributed funds with which to conduct a large scale research program and a new Accounting Principles Board was established. The governing Council of the Institute stated the objective of the new program to be:

> To advance the written expression of what constitutes generally accepted accounting principles, for the guidance of its members and of others. This means something more than a survey of existing practice. It means a continuing effort to determine appropriate practice and to narrow the areas of difference and inconsistency in practice.

Six research studies have been published under the new program and the Accounting Principles Board has issued four official opinions. The research studies are in no sense statements of the official position of the Institute. They are to be widely circulated with the hope that they will stimulate interest and discussion before the Board makes a pronouncement on a subject. The weight which should be given to official opinions of the Accounting Principles Board is not settled, but the following resolution was adopted at the Spring, 1964 meeting of the Council:[2]

---

[1]Storey, p. 49.

[2]"News Report," The Journal of Accountancy, V. 117, No. 6 (June, 1964) 9.

> Resolved--That it is the sense of this Council that reports of members (on financial statements) should disclose material departures from opinions of the Accounting Principles Board, and that the President is hereby authorized to appoint a special committee to recommend to Council appropriate methods of implementing the substance of this resolution.

The significance of this resolution is far reaching. It focuses attention on the very nature of the accountant's certificate as a judgment on the part of the accountant that the financial statements of the company not only portray the financial facts "fairly" but also that the methods followed are at least up to the minimums recognized as "generally accepted." It will strengthen the basic concept that the users of financial statements can assume that the statements are prepared by methods at least as sound as the "principles" which gain official recognition. If those principles do not fit the particular situation, the company or industry involved does not have to follow the Board's pronouncements but the certificate must call the attention of the reader to the departures. The reason for mention in the certificate is not to cast reflection on the statements in such situations, but, rather, to call attention of the reader to the fact that the statements must be interpreted differently than the statements of most firms.

An evaluation.--It is possible that the current emphasis on deriving a list of principles, if that is part of the goal of present research, may have caused accountants to temporarily lose sight of a fundamental which has an important bearing on this study. The outstanding feature of double entry accounting is the complete integration of all of the accounts, both real and nominal. This carries to the underlying concepts, standards, principles or whatever one chooses to call them. Each affects the other and it is the complete result that the accountant appraises. The term

"generally accepted accounting principles" is in reality a shorthand expression which encompasses a broad spectrum of complex but not as yet specifically defined concepts which should apply to all businesses. The professional accountant is not as bothered by lack of a list of principles as non-accountants might think. He can visualize how a particular set of procedures will affect the reports of a business and can evaluate whether or not they will be fair reports of accountability. He is probably most concerned with the problem of choosing the best alternatives from several which meet the minimum criteria of general acceptance.[1]

At the same time, one must not lose sight of the fact that financial statements are more than just a report of accountability by management. The framework is that of double entry accounting summarized into a report of accountability by management, but much of the usefulness of accounting data comes from the inherent qualities of such a report, such as accuracy, objectivity, control and reliability. Data with these qualities have many uses which business is just coming to realize. Even though generally accepted principles have been developed for reports by management to stockholders and creditors, this same report and analyses of the detail back of it are extremely valuable to management for internal use. Areas such as cost accounting are tied to the double entry records in order to take advantage of the inherent characteristics of these records. The principles which guide them therefore have a profound effect on internal management accounting.

---

[1]See, for example, Herbert E. Miller, "After There is Agreement on Broad Accounting Principles - What Then?" The Texas CPA, V. 34 (September, 1961) 3-6.

If accounting is to achieve its maximum usefulness, public confidence and understanding are essential. Accountants must strive to identify as many of the broad spectrum of interrelated concepts as possible. This is important not so much for their own understanding but as a means of giving the public an insight into the relationships involved.

Perspective.--The foregoing discussion of the goals of present research is designed to provide a basic understanding of what is meant by the phrase "generally accepted accounting principles." It gives an indication of the range of practices which can be employed and still permit the statements to bear the label "generally accepted." Most important, it indicates why no attempt is made to state specific generally accepted principles in this study. Hopefully it conveys the understanding that, although accepted principles are hard to define, recognition of non-acceptable procedures is not difficult when their effect is tested against the basic framework of accountability by management.

DEVELOPMENT OF THE LIFE INSURANCE CONVENTION BLANK

Structure of the Present Blank

Before tracing the development of the life insurance Convention Blank it is helpful to note a few of the structural features of the present blank. Pertinent pages of the blank are included herein as Appendix III.

All of the state insurance departments require insurance companies operating in their state to file the uniform annual statement called the

Convention Blank.[1] This report is designed by the Blanks Committee of the National Association of Insurance Commissioners and is reconsidered annually. An insurance company may adopt any accounting system it chooses so long as it is able to complete the Convention Blank satisfactorily and so long as the insurance department examiners can trace what was done. However, the blank requires so much detail that there is little practical room for variation in the accounting system.

The accounting system which makes completion of the blank easiest is one characterized as "modified single entry" or "incomplete double entry." Double entry books are kept for cash transactions only. Non-cash items, accruals, and all liabilities are maintained in memoranda accounts or are determined by analyses or by inventory at the end of the accounting period, and are brought onto the statement by what amounts to adjusting entries.[2] The Convention Blank is in many respects a worksheet for compilation of the data which eventually are summarized into the basic financial statements on pages 2, 3 and 4 of the blank. This can most easily be seen by examining Table 1, which reproduces selected lines from Exhibit 13 of the blank filed by one of the companies analyzed in Chapter IV: (A copy of the complete form for Exhibit 13 appears in Appendix III).

---

[1]This designation was probably started when the National Association of Insurance Commissioners was called the National Convention of Insurance Commissioners. The term "Annual Statement" is also used to describe the report, but is not used in this dissertation, except in direct quotation, in order to avoid confusion with the annual report to stockholders and/or policyholders.

[2]Insurance Examination Committee, Dallas Chapter of Texas Society of Certified Public Accountants, unpublished manuscript A Brief Introduction to the Financial Statements and Taxation of Life Insurance Companies, May, 1963, p. 12.

Table 1: Selected Lines from Exhibit 13 of the 1962 Convention Blank of Company F

	Ledger Assets (1)	Add: Non-Ledger Assets (2)	Deduct: Assets Not Admitted (3)	Net Admitted Assets (4)
1. Bonds	$223,777,608		$ 60,000	$223,717,608
2. Stocks	30,279,318	$13,632,240		43,911,558
. . .				
12.3 Furniture and equipment	1,253,085		851,563	401,522
. . .				
19.1 Interest due and accrued		2,854,038		2,854,038
. . .				
Totals	$397,709,671	$27,527,777	$832,296[a]	$424,405,152

Source: The Convention Blank filed with the Nebraska Insurance Department.

[a]There are negative amounts in this column so the total is less than line 12.3.

Those assets for which there are accounts in the ledger because they result from cash transactions are entered in column (1). Other assets are brought onto the statement by entering them in column (2). For such assets as corporate stocks, the amount entered in this column is the difference between the book value of the asset and the value at which it must be carried in the statement. Accrued assets and inventories are normally entered in column (2) rather than by making adjusting entries in the ledger.

Certain assets do not qualify as legal investments of insurance reserves, so cannot be shown in the balance sheet. They are eliminated by entering them in column (3). In the above tabulation, one bond issue no longer meets statutory requirements and the only furniture and equipment which is admissible is electronic data processing equipment. The net figure in column (4) is the amount which must be carried to the balance sheet.

Many public accountants who serve small commercial businesses use a similar system. The business keeps its books on the cash basis, but provides the public accountant with lists of unpaid accounts, accruals,

receivables, etc. The public accountant enters these as adjustments on his worksheet in order to produce statements on the accrual basis. He ordinarily enters these adjustments in the ledger at the end of the year only, using cumulative adjustments on each succeeding worksheet during the year. Insurance companies do not enter adjustments in the ledger, but let the Convention Blank serve as a permanent record.[1]

The computation of operating figures follows a similar plan for the broad groups carried to the Income Statement, but individual categories are reported on the cash basis only. For example, Table 2 is excerpted from Exhibit 5--General Expenses for the firm in Table 1.

Table 2: Selected Lines from Exhibit 5 of the 1962 Convention Blank of Company F

	Insurance			
	Life (1)	Accident and Health (2)	Investment (3)	Total (4)
1. Rent	$ 403,959	$ 46,511	$ 36,670	$ 487,140
2. Salaries and wages	3,126,669	367,003	357,284	3,850,956
. . .				
10. Total general expenses paid	$6,597,533	$604,044	$1,490,284	$8,691,861
11. General expenses unpaid December 31, current year	357,537	66,978	42,180	466,695
12. General expenses unpaid December 31, previous year	347,795	89,843	46,519	484,157
13. General expenses incurred during year (10 + 11 - 12)	$6,607,275	$581,179	$1,485,944	$8,684,398

Source: Convention Blank filed with the Nebraska Insurance Department.

---

[1]The following example of one company believed to have typical portions entered in the ledger and portions brought onto the statement by "adjustment" is cited in the manuscript by the Dallas Chapter of the Texas Society of Certified Public Accountants referred to in the footnote on page 39.

	Per Cent of Dollar Amount		
	Ledger	Non-ledger	Total
Assets	93.6%	6.4%	100.0%
Liabilities	0.5	99.5	100.0
Surplus and other funds	13.1	86.9	100.0

The <u>cash</u> <u>expended</u> for each class of expense must be entered on each line of Exhibit 5, broken into the three "departmental" columns. After the total cash expenditure for each "department" is accumulated in line 10, the beginning accounts payable are added and the ending accounts payable are deducted to arrive at total expenses on the accrual, or revenue, basis. Similar schedules and computations are required for all revenue and expense. If records are kept on the full accrual basis, it is necessary to reverse the accruals for each category of expense in order to obtain the figures for each on the cash basis. Firms which have tried accrual accounting have generally given it up after a few years. For example, the report of the State Insurance Department Examiners on one of the companies analyzed in Chapter IV notes: "During the examination period (3 years) the Company changed its accounting system to the accrual basis. This procedure complicated preparation of the Annual Statement and was discountinued January 1, 1962. . . ."

Care must be taken, however, not to let what seems to the commercial accountant a rather unsophisticated methodology lead one to hasty criticism. In most commercial firms, the liabilities can be precisely determined from the accounting records, but certain assets, particularly inventories, have to be determined by a valuation process. In life insurance, most of the assets are specifically determinable, but the largest liability--the insurance reserves--must be determined by a valuation process. In a sense, the physical inventory procedure used by trading firms is also used for the reserve liability by life insurance companies. The task of valuing reserves is so monumental that it tends to overshadow other aspects of insurance accounting.[1]

---

[1]Reserves are discussed in Chapter III in connection with the Group IV adjustments.

As one works with the Convention Blank, he must remember that it must be used by all firms, large and small. He should not forget that the purpose of the blank is to provide the state insurance departments with the data they need. The Convention Blank with its many detailed lists of specific assets, proofs and detailed analyses bears marked similarities to the set of working papers compiled by a public accountant on an audit. The insurance commissioner and his staff may use the analyses in the blank much as a reviewing principal in a public accounting firm does the audit work papers in evaluating the report he is asked to approve. Although the insurance company prepares its own Convention Blank, the authenticity of the company analyses is ordinarily verified once in three years with an examination by insurance department examiners.

One final preliminary observation must be made. Most states have statutory restrictions similar to Nebraska whereby insurance companies are prohibited from publishing financial statements which do not "correspond with or include the corresponding items from its verified statement made to the Department of Insurance."[1] The history of the Convention Blank is, therefore, also the history of life insurance financial reports.

The Questionnaire Period

Although a Massachusetts statute had required publication of its financial condition as a charter provision of an insurance company as early as 1799, the Convention Blank had its genesis in a New York State law of 1828 which required all "monied corporations" to file an annual statement with the state comptroller. The form adopted by the comptroller

---

[1]Sec. 44-324, Revised Statutes of Nebraska.

was not a financial statement but just a list of items, including capital stock, real estate, debts and claims against the company. Surrey points out that although this form was used until 1848, its value was slight because many items were left out.[1] The 1828 form was revised in 1848 but the changes were more in the nature of form than of content.

Massachusetts enacted legislation in 1837 which applied specifically to insurance companies. The statement required was briefer than the New York form and tended to stress a listing of the assets rather than reserves and liabilities. The statement was not in questionnaire form like the New York form, but neither was it a balance sheet because there was no account to show the proprietary interest other than a statement of capital.[2]

Surrey found three examples of New York Companies which went beyond the requirements of the questionnaire and used a formula type of report in 1850. The Mutual Life Insurance Company's report, its first, is particularly interesting because it bears a marked resemblance to the Convention Blank primary statement used until 1951, and retained as Exhibit 12 of the current blank. It is a formula which tries to integrate the receipts and disbursements with the assets, but shows no indication of an understanding of double entry accounting.

---

[1] Sterling Surrey, _The Development of the Convention Form of Life Insurance Statement_ (Philadelphia: Unpublished dissertation at the University of Pennsylvania, 1950) 3.

[2] Surrey, p. 14.

Table 3: Format of Statement Included in 1850 Report of Mutual Life Insurance Company to Comptroller of the State of New York

Net Assets 1/31/1849		$ 000
Receipts:		
For premiums	$ 000	
For interest	000	
Profit on sale of securities	000	000
Total		$ 000
Disbursements:		
For losses paid	$ 000	
For surrendered policies	000	
For salaries, etc.	000	
For commissions	000	000
Assets 1/31/1850		$ 000
Less: Losses incurred, not yet paid, waiting proof of death		000
Net Assets		$ 000
(Followed by an itemized listing of the investment in these assets)		
Liabilities (not listed)		$ 000

Source: Sterling Surrey, The Development of the Convention Form of Life Insurance Statement, p. 19, (Original source: Barnes, New York Insurance Reports, Condensed edition, Vol. I, p. 626).

Surrey calls this presentation "a marked improvement over the required form."[1] The two features which are most significant are (1) the listing of specific assets with little attention to liabilities, and (2) receipts and disbursements are used to prove the change in assets.

First Financial Statement Forms

Experimentation and growth

The individual states were involved in considerable accounting experimentation around 1850 and insurance statements evolved rapidly.

---

[1] p. 20.

New York adopted a form in 1854, and used it until 1859, which used an account classification technique rather than a questionnaire. Accounts were divided into assets and liabilities, although a balance between these two groups was impossible because insurance in force was included in liabilities. The assets, however, were balanced with a capital and accumulation account. An income and expenditures schedule was included, but the balance of income over expenditures did not account directly for net balance sheet or even net asset changes. Clearly, double entry accounting was not part of this statement, nor were the stewardship aspects of the statement submitted by Mutual Life Insurance Company in 1850 recognized. The statement was little more than a well organized grouping of data which the regulatory agencies needed.

The New York Insurance Department was created by a legislative act of 1859. The first insurance superintendent designed a blank which had two notable features. First, insurance in force was dropped from the list of liabilities and a reserve for reinsurance took its place. Second, provision was made for accrued interest. However, assets were not balanced with the liabilities because the law permitted a degree of impairment of capital. This impairment was apparently permitted to cover organization and beginning operating costs. The statutes varied but a 20 per cent impairment limitation was common.[1]

Adoption of the present formula

The first balancing of assets and liabilities was in the Massachusetts Blank of 1867. This was accomplished by including an account "surplus over

---

[1] Edwin W. Patterson, *The Insurance Commissioner in the United States* (Cambridge: Harvard University Press, 1927) p. 211 and 144.

capital" in the liabilities section.[1] This established the basic formula which has governed insurance company balance sheets since that time--Surplus is the difference between the value of assets and liabilities (including capital stock). Considerable understanding of the basic structure of insurance financial reports can be gained by speculating about the possible reasons for adoption of this formula.

Impairment of capital concept borrowed from dividend law.--The old corporation law in America held that dividends should not be paid out of capital; nor when capital was impaired.[2] The insurance formula likely had its genesis in this concept of impairment of capital. It should be noted, however, that there is no universal provision regarding dividends. The most comprehensive treatise, Kehl,[3] points out that there are no English common law precedents in the area, and that statutory provisions in every state include in substance one or more of the following limitations: (1) insolvency, (2) surplus and (3) profits. Each of these has several variants. For example, insolvency may mean simple inability to pay current debts or may be used in the bankruptcy sense. In some states, profits may mean the profits for the current year even though capital is impaired, and may or may not mean the profit shown in the firm's financial statements.

---

[1]Surrey, p. 66.

[2]Adolf A. Berle, Jr. and Gardiner C. Means, The Modern Corporation and Private Property (New York: The Macmillan Company, 1934) 146.

[3]Donald Kehl, Corporate Dividends (New York: The Ronald Press Company, 1941).

Accountants are often shocked to find that the legal interpretation is not the same as general usage in accounting. This is particularly true of the surplus limitation.

The position of some courts regarding the meaning of impairment of capital and surplus was stated in a 1940 New York decision in unequivocal terms. The New York statute contained the following provision: "No stock corporation shall declare or pay any dividend which shall impair its capital or capital stock, nor shall any such corporation declare or pay any dividend . . . unless the value of its assets remaining after the payment of such dividend . . . shall be at least equal to the aggregate amount of its debts and liabilities including capital or capital stock." The directors were being sued because they had declared a dividend which allegedly impaired capital. The trial judge pointed out that "the test being whether or not the value of the assets exceeds the debts and the liability to stockholders, all assets must be taken at their actual value . . . . This view required directors to make a determination of the value of the assets at each dividend declaration. What the directors must do is to exercise an informed judgment of their own . . . . If directors have blindly or complacently accepted either cost or any other arbitrary figures as indicative of value, they have not exercised either discretion or judgment . . . . I find ample evidence to sustain and satisfy the judgment of the directors that the value of the land and improvements exceeded

the sum at which they were carried on the books by an amount sufficient to show a surplus greater than the amount of the dividends."[1]

As will be emphasized repeatedly in this study, the formula adopted for insurance reporting purposes starting with the Massachusetts Blank of 1867 is the same formula applied by the judge in the dividend case just discussed. The only significant differences are that the National Association of Insurance Commissioners has adopted detailed and specific valuation techniques for assets instead of leaving valuation up to the company or its governing board, and permit only certain kinds of readily marketable assets to be included.

Legal assumptions about balance sheets.--Another possible explanation for adoption of the formula type balance sheet lies in the background of legislators and the early state insurance officials. Many of them undoubtedly had legal training, but likely few or none were trained accountants. The attorney in those days was most apt to be concerned with financial statements when a partnership was being formed or liquidated. Partnership settlements are on the basis of values of assets less the claims of creditors. Either the assets are sold and the proceeds divided, or a hypothetical sale takes place by agreeing on the value of assets. Beyond the realm of partnership law, the post Civil War attorney was concerned with the values of assets less prior claims in such areas

---

[1]Randall v. Bailey 23 N.Y.S.2d. 173; aff'd 228 N.Y. 280, 43 N.E.2d 43. This is, of course, the position of a New York court only and might not be followed in other states where the word "value" is not used so prominently in the statute. The Model Corporation Act entitles the directors to rely in good faith on book values (¶ 41). Oleck notes that "If the directors do not rely on book values in good faith, then they must substitute some other value and are responsible for the value adopted by them." Howard L. Oleck, Modern Corporation Law (Indianapolis: The Bobbs-Merrill Company, Inc., 1959) V. 2, ¶ 611.

as estate settlements, suits for damages or collections on a judgment. So, it is reasonable to assume that regulatory officials with legal training would think of a balance sheet as a computation of equity using the value of assets less liabilities.

Elizur Wright.--No speculating needs to be done about the influence of Elizur Wright, a mathematician often regarded as the father of American legal reserve insurance. Two of his innovations had a profound affect on insurance reporting: (1) his insistence on the net premium method of valuation of reserves and (2) the establishment of the balance sheet as the first line indicator of solvency.

Wright was an abolitionist who turned his crusading zeal to insurance after attending an auction of existing life insurance policies in England. Surrender values in a life insurance policy were rare at that time, so it was a common practice in England for old people who could no longer pay their premiums to offer their policies for sale and to "place themselves on the block" so that prospective purchasers could appraise their general health and prospects for a short remaining life. The buyer made himself the beneficiary of the policy and took over the premium obligations in the hope of eventually collecting more from the policy than he put into it.

Wright became a lobbyist in the Massachusetts legislature, campaigning for a law which would establish a state insurance commission which would not only calculate proper policy reserves and cash surrender values based on them, but also would have the power to enforce these reserve liabilities upon the companies. He was convinced that reserves on whole life policies were often so inadequate that the solvency of the companies was endangered. He urged and gained acceptance of the net premium method of calculating reserves, as opposed to the gross premium method used in England and

calculated a monumental set of net reserve valuation tables which were adopted by Massachusetts in 1850 as a basis for judging the solvency of companies.

In 1858 Wright was appointed as one of a two-man board of insurance commissioners and in 1861 he was able to secure passage of his non-forfeiture law. His concern for policyholders and adequate reserves can be grasped from the fact that while in office he started and maintained a registry book in which he listed every single policy issued in the state together with the yearly calculation showing what the reserve should be at any point. He kept this registry open to any policyholder who wanted to see what the reserve on his policy should be.[1]

How Wright's formula is used in regulation.--The balance sheet of life insurance companies has remained a formula for computation of legal surplus since 1867. The most difficult figure to obtain is the aggregate reserve for all of the insurance policies. Once the actuary has obtained this aggregate, it and the other liabilities are subtracted from the *value* of the assets to determine surplus. This surplus is used as a first line indicator of solvency of the company and therefore the ability of the insurance company to fulfil all of the terms of every insurance policy in force. This solvency is forward looking in the sense that the company could cease to write new business and still remain solvent as long as necessary to fulfil all of its contracts. This naturally assumes that the actuarial assumptions will not be exceeded in fact.

---

[1]The discussion in Robert I. Mehr and Robert W. Osler, *Modern Life Insurance* (New York: The Macmillan Company, third edition, 1961) 673-675 is drawn on heavily in this discussion of Wright.

The use made of this computation of surplus formula was effectively stated by John A. McCall, one of the influential early commissioners: "The theory . . . presupposes that the company will always have on hand a certain amount from each premium to be improved at interest" and that "the state . . . declares not what a company shall charge for insurance, but what it shall have on hand upon contracts already in existence in order to continue in business . . . ."[1] The formula which comprises the framework of the life insurance balance sheet is an attempt to measure whether or not the firm does have salable assets sufficient to meet the statutory reserve requirement after payment of liabilities.

Development of two important aspects of the formula

Non-admitted assets.--Assets which could not be readily sold to meet policy obligations were soon recognized as having no place in this formula. In 1866, the New York Commissioner objected to including such things as commissions to agents in advance as assets.[2] This was not a mere technicality but a matter of whether or not a reserve really existed. In 1870 his report included the illustration reproduced in Table 4.

---

[1] John A. McCall, "The Scope and Grounds of State Supervision of Life Insurance in the United States," Proceedings of the National Convention of Insurance Commissioners, 1902, p. 90. Mr. McCall was president of New York Life Insurance Company at the time he delivered this address.

[2] Surrey, p. 55.

Table 4: Percentages of Selected Assets to Total Assets in Five Companies Reporting to New York Superintendent of Insurance in 1870

Company	Per Cent to Total Assets			
	Premiums In Hands Of Agents	Deferred Premiums	Premium Notes	Totals
A	30%	10%	35%	75%
B	55	10	10	75
C	10	0	50	60
D	15	10	50	75
E	15	10	33	58

Source: Sterling Surrey, The Development of the Convention Form of Life Insurance Statement, 57 (Original Source: New York Reports, 1870, p. viii.)

The solution was found in classifying these items as non-admitted assets and excluding them from the computation of legal surplus. In 1871, both the Massachusetts and New York Commissioners segregated the following as unadmitted: agents' balances, cash in hands of agents, loans or advances to officers and agents payable from their salary or future commissions, and stationery or future commissions.[1] As will be seen in the analyses of specific companies later in this study, these items are among those considered non-admitted today.

Proof of change in ledger assets.--Another development of this time which helps explain the Convention Blank of today was the adoption of the form of statement which the Mutual Life Insurance Company voluntarily submitted in 1850,[2] wherein receipts and disbursements were used to prove the change in assets. This necessitated keeping assets on the cash basis so that the net change in cash exactly equaled the increase or decrease in "Ledger assets." The start toward the accrual basis which had been made

[1]Surrey, p. 58.

[2]See Table 3.

by the first New York commissioner was abandoned. One cannot help but wonder why someone did not come on the scene who knew double entry bookkeeping and could have shown how that system automatically integrates the entire balance sheet and the income accounts into an over-all proof. One must remember, however, that although most large businesses used double entry bookkeeping at this time, there was no significant publication of financial statements until early in the twentieth century. The information asked for by the insurance departments must have seemed most revealing of confidential data and one can guess that the companies were not anxious to extend the reports to include the proofs and control inherent in double entry.

The Static Period Under the Convention Blank

Adoption

As more and more states adopted regulatory laws, each with its own requirements, forms to be submitted, depository regulations, etc., it became obvious that coordination and uniformity was required. In 1871 the National Convention of Insurance Commissioners was formed. This organization drew on the best features of the various state blanks then in use and, in 1875, adopted a uniform blank which remained essentially unchanged until 1951.

The gain and loss exhibit

Most of the changes in the Convention Blank prior to 1951 were by way of additional detailed schedules, particularly following the Armstrong Investigation in New York in 1905. In 1895 a so-called "gain and loss exhibit" was added to the blank. This exhibit has had a turbulent history and was the subject of intensive and bitter debates for many years. It

was deleted from the blank for a number of years between 1900 and 1906, but, in or out, it was the center of considerable debate at every annual meeting of the commissioners for over a decade.

The Gain and Loss Exhibit was originally devised during an insurance department examination in an effort to explain the difference between the beginning and ending surplus, but included a complicated attempt to compare actual experience with actuarial assumptions. A comparison of the following items comprised the basic structure of the exhibit:[1]

Loading	cf.	Actual expenses
Interest required to maintain reserves	cf.	Interest actually earned
Expected mortality, net	cf.	Actual mortality minus reserves
Reserves released by terminations other than death	cf.	Values allowed policyholders on such terminations

Each of the items on the left side was computed according to the mortality table and interest rate specified for determination of statutory reserves. Yet the insurance companies, then as now, based premiums on more realistic mortality tables than those required by statute for valuation of reserves.[2]

The chief difficulty with the exhibit had its root in two factors: (1) The exhibit was prepared on the accrual basis, but the books and the primary statements were prepared on the cash basis, and (2) Actuarial

---

[1]C. O. Shepherd, "The 'Convention' Statement of Life Insurance Companies" The Record, American Institute of Actuaries, V. 26, No. 54 (1937) 181.

[2]I. M. Krowitz, "Gain and Loss Exhibit," in Adelbert G. Straub (ed.) Examination of Insurance Companies (New York: New York Insurance Department, 1954, IV) 321.

factors were introduced into the exhibit which were not practically possible to record in the books.

A missed opportunity.--The Gain and Loss Exhibit was first introduced into the blank at the exact time the New York Stock Exchange finally established a firm rule that a balance sheet was mandatory in every listing application. The insurance industry was, however, working with the formula which had been established in 1875 without recognizing that double entry bookkeeping centered on an income statement and that the income accounts were an integral part of the system even though only the balance sheet was published. They apparently did not realize that double entry records on the accrual basis could integrate the balance sheet and revenue accounts and provide an automatic proof. Had they adopted a double entry system and segregated the analytical actuarial and budgetary schedules from the formal statements, the insurance industry could have had a report far in advance of anything commercial business publishes today. Shepherd summarized the situation well with the following observation, even though he failed to recognize that the revenue and expense accounts were always an integral part of double entry:

> The idea of actuarial analysis along gain and loss lines was born ten or fifteen years too soon. With the growing realization in general business and accounting circles that accrued items in assets and liabilities called for accrued items in income and outgo, and with the development of reserves in general business . . . it seems altogether probable that life insurance might have followed general accounting practice and adopted a Net Income statement.[1]

Lessons of experience.--The hard work the insurance industry created for itself by not adopting the type of proposal suggested in the preceding paragraph can be visualized by the statement made by one commissioner in

---

[1]Shepherd, p. 184.

campaigning against inclusion of the Gain and Loss Exhibit in the blank: "Its author, in the examination of a company, tried to make up a gain and loss exhibit, and he was only a million and a half dollars out of balance."[1] At the same meeting, another speaker pointed out that "all companies estimate some items in the exhibit, . . . some estimate what others calculate, while calculating what others estimate, and . . . excepting those who enter a balance unaccounted for, every company has an item which represents a forced balance."[2] One of the perplexing factors in the portion of the research for this dissertation which was done before gathering the historical material was the appearance of the out-of-balance account in the Gain and Loss Exhibit for Company C for every year until 1939.

Even though insurance companies made considerably more information available to the public regarding assets than commercial and industrial companies did during the last half of the nineteenth century, they were apparently no more willing to devulge operating data than other firms. For example, the 1902 Connecticut Insurance Report notes a complaint by companies that the Gain and Loss Exhibit "transcends the purpose of official supervision, in that it requires a company to disclose conditions which neither the policyholder nor the public has any right to be informed about."[3] Companies were, however, properly concerned with how the data in the gain and loss exhibit were used. The danger was called to the attention

---

[1]Comment by Mr. Fletcher, _Proceedings of the National Convention of Insurance Commissioners_, 1906, p. 83.

[2]Comment by Mr. Vorys, p. 69.

[3]H. Pierson Hammond, "The History of the Development of the Gain and Loss Exhibit of Life Companies," _Proceedings of the National Convention of Insurance Commissioners_, 1924, p. 244.

of the 1906 convention of the commissioners by Mr. Vorys with the warning that although the gain and loss exhibit serves a good purpose internally and for the state insurance department, "it does not serve that purpose when . . . someone (makes up) a lot of ratios--tables we are all familiar with--ratios of expected to actual mortality, of interest earned and required on reserves, of loading for expenses and actual expenses, etc. And it is herein that the harm is accomplished."[1]

In 1925 the old exhibit was split into two statements, a "Gain and Loss Exhibit" and an "Exhibit of the Changes in Surplus for the Year According to Classes or Lines of Business." The idea was commendable, but the change was really not much more than a rearrangement of the forms in use prior to 1925.[2]

The shift of commercial accounting emphasis to the income statement during the 1920's and the research programs of the professional accounting societies which commenced in the 1930's were felt by the insurance industry, if not by the regulatory officials. Substantial changes were made in the gain and loss exhibit in 1939, due in part to the urging in the article by C. O. Shepherd which is cited several times in the preceding paragraphs, and further stimulated by the hearings which the Temporary National Economic Committee was holding at that time. This new exhibit was finally able to reconcile the change in surplus during the year. The format made it less easy for those who did not understand what was involved to pick up one or two ratios and use them to reach unwarranted conclusions. The data were

---

[1]Proceedings, p. 70.

[2]Surrey, p. 135.

still available, however, so that those who knew what the ratios properly portrayed could compute them easily.

The 1939 gain and loss exhibit was still relegated to secondary place in the report, and the income and disbursements statement remained as a proof of change in ledger assets--that is, those assets recorded on the cash basis. The basic formula was still fundamentally the same as the one adopted in 1875. This formula, incidentally, has much in common with the supposedly new dynamic concept of cash flow. Its usefulness in the type of analysis which the state insurance departments need to do in carrying out their statutory obligations is attested to by its retention in the Convention Blank, even at the price of foregoing the integration of all accounts into an automatic proof, and the other advantages, inherent in double entry.

The 1951 Revision of the Convention Blank

Attempts at revision of the Convention Blank were made in 1895, 1914, 1925, 1939 and 1951. The first four resulted in added exhibits and more detail or the splitting of one exhibit into two or more, but few changes of substance were made. The Armstrong Investigation of 1905 resulted in an increase in the amount of detail and the addition of previously undisclosed information. All of this additional detail was important to regulatory officials but its inclusion did not change the basic financial statements.

Changes recommended by the insurance associations

The 1951 revision stemmed from the joint efforts of the Life Insurance Association of America and the American Life Convention rather than from the insurance commissioners. These two organizations formed a joint committee

in 1941. Three discussion versions of a new blank proposal were submitted to member companies and interested persons before its report was formally made to the National Association of Insurance Commissioners. The joint committee stated that their objective was to "have a Statement which is, as nearly as may be, in the form generally used by other corporations and as understandable to the public as the intricacies of our business permit," and which, at the same time would "include the information necessary for proper supervision by the State Insurance Departments."[1] The most important change in the financial statements in the blank recommended by the joint committee was the adoption of a double entry system of reporting on the accrual, or revenue, basis with full integration of the balance sheet and the nominal accounts. Three primary statements were to be included: A Balance Sheet, a Statement of Income, and a summary of the Surplus Account. This does not mean that the committee anticipated abandonment of the modified single entry system of keeping the records. Worksheets could be used to convert the data to full accrual double entry basis. But, it would also have been possible for a company to use full double entry accrual accounting, leaving only reserves to be picked up by adjusting entry similar to the way inventories are usually handled in trading firms, and handling other adjustments in the same way as commercial and industrial firms.

Even though an accrual basis income statement was integrated into the proposed statement, the Gain and Loss Exhibit was retained. However, it

---

[1]Joint Committee on Blanks of the Life Insurance Association of America and The American Life Convention, <u>Discussion of Revised Form of Annual Statement for Life Insurance Companies</u>, December, 1947, p. 3.

became a supporting departmental analysis of each item in the Income Statement. Actuarial information regarding reserves was in separate analyses.

The blank adopted

The National Association of Insurance Commissioners adopted many of the recommendations of the joint committee, but not all of them. The joint committee pointed out that their proposed statement "contains more information than the current form of statement; it also includes practically all of the information which is available in the current Statement and much of the information is given in greater detail. It is believed that this form of statement will be understood by general accountants and is more in line with the type of Statement which is recognized today."[1] The National Association of Insurance Commissioners apparently did not agree. Wightman's version of what happened to the proposed blank is: "The Commissioners' Committee's recommendations reflected an attempt to effect a compromise between the form of Blank then in use and that proposed by the Joint Committee. The 1951 Blank, while outwardly seeming to conform to the suggestions of the Joint Committee, is in effect primarily a mere rearrangement of the data presented in the blank previously prescribed."[2]

The features of the blank which was adopted were outlined in the introduction to this section, and are examined in detail in later chapters. It should be emphasized, however, that the primary statements are on the

---

[1]Discussion, p. 3.

[2]E. C. Wightman, Life Insurance Statements and Accounts (New York: Life Office Management Association, 1952) 40.

accrual basis but the cash basis is maintained for all of the rest of the statement, with the computations of adjustment to accrual shown in each exhibit. The old formula for proof of ledger assets was moved from the primary spot to Exhibit 12. A member of the Blanks Committee in 1950 and 1951 stated informally to the writer that the reason for retention was that dropping it would have required revision of the examination procedure. However, the similarity to a statement of cash flow must have been recognized by some of those who urged its retention as a supporting schedule. In their analytical work they must have found certain stewardship and analytical attributes of this statement superior to the balance sheet in some respects. Commercial and industrial firms are now being urged to include a statement of source and application of funds in their annual reports in order to gain some of these advantages. Except for the concentration on cash instead of "funds" the insurance industry was seventy-five years ahead in this respect.

Regulatory needs

Apparently the insurance commissioners have found that they can best carry out their statutory obligations by working from the details of cash transactions. In this study, it is assumed that the Convention Blank provides the regulatory officials with precisely the information they need. Concern herein is with the possibility of extending the statements to include data from the detailed schedules in the blank and other data readily generated by the companies in a way which would provide information of interest to the stockholder.

Evaluation

One item of evaluation is, however, appropriate to the theme of this study. Considerable criticism appeared in the literature regarding the three-way classification of assets prior to 1951.[1] It is agreed that the breakdown between non-ledger assets and ledger assets was pointless as far as reports to stockholders are concerned. This breakdown is a matter of procedure in accumulation of data and is of no more concern to the stockholder than a breakdown of the figures before and after adjusting entries would be in a commercial or industrial firm. The non-admitted assets are another matter. Removal of these assets from the balance sheet, coupled with the requirement that all published statements must agree with the Convention Blank, may be the basis for a large portion of the present dissatisfaction with insurance company reports to stockholders. When non-admitted assets are removed from the balance sheet, that balance sheet is no longer a complete report of accountability by management, but just a balance sheet of the "reserve fund," a commendable schedule if it were just properly labeled. Had the insurance industry left the non-admitted assets in the balance sheet, readers would have been able to see at a glance that the insurance industry statements have some distinctive features and must therefore be interpreted differently than the statements of other firms. The form of balance sheet which must now be used in all published reports is misleading in that it looks like the statement for commercial and industrial firms when in fact it is quite different.

[1]Ledger assets plus non-ledger assets equals gross assets. Non-admitted assets were listed and subtracted from gross assets to arrive at the net admitted assets which were used in the computation of legal surplus.

CHAPTER III

TYPES OF ADJUSTMENTS NECESSARY IN ORDER TO EXTEND THE FINANCIAL STATEMENTS OF LIFE INSURANCE COMPANIES TO CONFORM WITH "GENERALLY ACCEPTED ACCOUNTING PRINCIPLES"

The preceding chapter used a comparison of the historical development of life insurance accounting and reporting and the historical development of commercial and manufacturing accounting to emphasize the difference between the underlying structure of the two systems. When one realizes that the basic framework of life insurance accounting is not founded on double entry bookkeeping but is, instead, an elaborate formula for the computation of legal surplus, a vital first step has been taken in understanding the differences between life insurance company financial statements and the financial statements of commercial and industrial firms. Both types of financial statements contain useful data not available in the other. Each is designed to meet the needs of a different set of users.

Life insurance company financial statements are designed to provide the information needed by regulatory officials in fulfilling their obligation to protect the policyholders. Their primary concern is the ability of the insurance company to fulfil the terms of every life insurance contract and pay all future claims when they arise. Serious misunderstanding occurs, however, when the financial statements designed to test these criteria for regulatory purposes are included in the published annual

reports which are sent to stockholders and the public. These users often attempt to interpret those financial statements in the same way they interpret the statements they receive from other concerns.

Several steps have been taken which are designed to minimize this misinterpretation. One of the important efforts was the American Institute of Certified Public Accountants' inclusion in _Statement on Auditing Procedure 32_ in the fall of 1962 of a requirement that when the statements required by a regulatory authority do not conform with generally accepted accounting principles, the independent Certified Public Accountant must call this to the attention of the reader by issuing a qualified or adverse opinion.

The difficulty with the solution adopted by _Statement 32_ is that many readers equate a qualified or adverse opinion with the idea that there is something wrong, rather than merely as a warning that the statements must be interpreted in a different manner than the statements of commercial and manufacturing companies. A more satisfactory solution would be to find a way of extending the regulatory statements so that the published statements could conform with accepted accounting principles _while leaving the regulatory statements unchanged_. The remainder of this report describes an attempt to do this.

The primary inquiry attempts to find the answers to four questions: (1) How close can one come to extending the Convention Blank financial statements into statements which conform with generally accepted accounting principles using just the data in the detailed schedules of the Convention Blank? (2) Where it is not possible to make satisfactory revisions using the data in the Convention Blank, is it reasonable to believe that insurance companies could make an appropriate conversion with the additional data

available to them or readily generated by them? (3) Are the adjustments which are required material and significant? (4) Would substitution of the extended and revised statements add important data not now available or cure a significant portion of the misinterpretation which now results from inclusion of the regulatory statements in the published reports? The answers to these questions are sought by attempting to make the conversions.

The steps by which the research was conducted are explained in detail in Chapters IV and V. This chapter is confined to an outline of the general nature of the revised financial statements and of the broad groups of adjustments which are made. However, those specific adjustments which apply to several companies are used to indicate the exact nature of each of the broad groups of adjustments.

REVISED FINANCIAL STATEMENTS

Many of the readers of financial statements have difficulty understanding them. This difficulty is compounded when the statements for a particular company or industry do not follow the same format and style as others, or when captions other than those the reader has become accustomed to are used. Every effort should, therefore, be made to have the same item shown in the same way by every concern. At the same time, an item which is truly different should not be made to look like something it is not, for the sake of uniformity and simplicity. The statements to which the Convention Blank data are extended in this study are designed to meet these criteria.

Generally Accepted Accounting Principles

The trial and error process through which the financial statements used in this study were developed is traced as the individual companies

are analyzed in Chapter IV and V. Certain preliminary considerations first had to be resolved, however, and these need to be reviewed briefly at this point even though they were developed more fully in Chapter II.

First of all, the position maintained in this study is that the primary requisite for any set of financial statements which conform with "generally accepted accounting principles" is that they fairly set forth the funds which have been made available to the firm and provide an accounting for what was done with those funds from a going concern point of view. This is the fundamental underlying structure which developed from the merging of double entry bookkeeping with the English stewardship reports. One of the most important expansions of this basic structure has been the emergence of the income statement as the most important statement, because it provides a measure of one of the sources of funds on one hand and a measure of how well the resources of the firm have been used to generate earning power on the other.

Second, it must be recognized that while the term "generally accepted accounting principles" is a shorthand expression which encompasses a broad spectrum of complex but not specifically defined concepts which apply to all businesses, these "principles" were developed primarily by commercial firms and were adapted for use by manufacturing firms without much alteration. The financial statements of commercial and manufacturing companies therefore provide the most accessible yardstick against which to evaluate the statements of industries which want to use the "generally accepted" label. This in no way indicates that the statements of commercial and manufacturing firms are necessarily better than those of other industries nor that there is not vast room for improvement. It casts no reflections on the quality of special purpose statements for regulatory or other purposes.

Third, the term "generally accepted accounting principles" used in the standard certificate developed by the American Institute of Certified Public Accountants refers primarily to the accounting involved in reports made by a business to outsiders, particularly stockholders and creditors.

Finally, the evaluation of whether or not an item is in accord with generally accepted accounting principles is made in the way accountants have traditionally made such a determination. An attempt is made to appraise whether the item meets the accountability, or stewardship, criterion in a way that would be understood by a reader who is reasonably familiar with the financial reports in annual statements to stockholders. The questions which are constantly asked are: (1) Would this item be handled in this way by a commercial or manufacturing firm which is recognized as following acceptable accounting? and (2) Do the statements provide the type of accountability data, including measurement of income, which stockholders and members of the public have come to expect management to provide regarding the firm? These questions are resolved by reference to the bulletins of professional accounting organizations, textbooks and periodical articles. Care is taken to distinguish between those minimum requirements which are barely sufficient for certification by the independent certified public accountant and those ideals which both the American Accounting Association and the American Institute of Certified Public Accountants are now searching for. The latter are insisted on as the basis for the adjustments only when clearly acceptable. If a practice meets an agreed on minimum and is being directed toward something better, it is considered "generally accepted" for purposes of this study.

Primary Objectives of the Financial Statements

Revised financial statements are included in Chapter IV for each of the firms analyzed in detail. The discussion in that chapter is arranged so that the statements progress from the simplest ones to the most complex. A general outline of objectives is needed at this point, however, as background for the discussion of the groups of adjustments which comprise the remainder of this chapter. The format of the statements themselves is reviewed when the first company is presented in Chapter IV.

Earnings statements are in comparative form. The objective is a reliable measurement of the flow of earnings at the point where they become available to management for alternative uses. Since different users of the financial statements are interested in different points of measurement, several sub-classifications of earnings are introduced--gross revenue, gross income, net insurance income, net income before income tax, net income, and net addition to unrestricted retained earnings. A combined income and retained earnings format is used rather than separate statements of income and changes in retained earnings. This is appropriate in view of the long-range nature of life insurance contracts.

The balance sheet poses serious problems. The primary objective is to reflect all of the funds which have been made available to the firm and the amounts invested in each of the assets those funds are used to acquire. However, state statutes restrict the information which can be published to that contained in the Convention Blank. It is therefore necessary to show the legal surplus figure and the National Association of Insurance Commissioners valuation of assets.

At first impression it seems impossible to do both. A format was worked out through trial and error, however, which includes both types of

data and is still simple enough to be comprehended. The primary statement is a traditional balance sheet with two modifications. First, the insurance reserves are listed at the top of the liabilities section and the revenue-producing assets in which most of these reserves are invested are listed at the top of the assets section. These are extra items which do not appear in the balance sheets of commercial and manufacturing concerns. Once this is recognized, it is possible to construct a traditional balance sheet with the remaining assets and liabilities. The only major change is that assets must be divided into what are called "admitted" and "non-admitted" items. These terms are defined when the Group I adjustments are discussed in the ensuing pages.

Second, the National Association of Insurance Commissioners valuation of assets is stated in a memorandum column, but is used to compute the legal "Policyholder Surplus". This surplus is then adjusted for the unrealized increment or loss in the N.A.I.C. valuations to arrive at the funds which must be accounted for. Hopefully, the resulting balance sheet provides something that no other industry has--a statement which reflects both the accountability for funds which is inherent in double-entry-type balance sheets, and a computation of solvency which comprises the regulatory type balance sheet.

The preceding outline should provide enough background to place the discussion of the groups of adjustments which follows into perspective. The discussion of the adjustments in turn provides the transition from the stipulations regarding generally accepted accounting principles to the financial statements themselves.

ADJUSTMENTS APPLICABLE TO MANY COMPANIES

Six groups of adjustments are made for each of the companies studied--both those analyzed in detail and those subjected to the abbreviated analysis. Each individual adjustment is listed in a detailed schedule for each firm and the group totals are carried over to a primary exhibit[1] in each instance, except for Company A which has so few adjustments that they are entered directly in Exhibit II.

The remainder of this chapter is devoted to a discussion of these groups of adjustments. In order to make the comments as specific as possible, those individual adjustments which apply to several of the companies are outlined at this point. This procedure has the added advantage of eliminating the necessity of going over these adjustments in the analysis of each firm. However, the discussion of those adjustments which are peculiar to a particular company is deferred to the next chapter so that they can be viewed against the specific attributes of the company involved. In many respects, some of the most interesting and informative findings of the research for this dissertation is reflected in the analysis of the adjustments which are peculiar to a particular company, but the present chapter is necessary in order to set the stage.

Group I Adjustments: Place Non-admitted Assets on the Statements

(Other Than Fixed Assets Which Are Included in the Group V Adjustments)

The balance sheets on pages 2 and 3 of the Convention Blank include every liability of the insurance company, but only those assets which meet

[1]For the companies analyzed in detail, the detailed schedule is "Schedule II(A)" and the primary exhibit is "Exhibit II". For the companies subjected to the abbreviated analysis, the detailed schedule is "Schedule 1" and the primary exhibit is "Exhibit A".

the legal requirements of eligibility for the investment of funds of a life insurance company in the state of the company's domicile.[1] The assets which do not meet these requirements are classed as non-admitted assets and are eliminated from the balance sheet through the process described in Chapter II. The offsetting expense debit is to either "Capital Gains and Losses" or "Gains and Losses from Change in Value of Non-admitted and Related Items." As can be seen in Exhibit II for any of the companies studied,[2] both of these accounts are reported as part of the Changes in Surplus Section of the blank rather than as operating income.

The fact that an asset is non-admitted does not mean that there is necessarily any question about its value to the insurance company from a going concern viewpoint, nor should there be any reflection upon the propriety or legality of the purchase of the asset. It simply means that it is not included in the list of items which qualify as admitted assets. Generally, only those classes of items which would clearly be salable at or above book value in case of liquidation are considered admissible by the National Association of Insurance Commissioners.

Since one of the purposes of a financial statement prepared in conformity with generally accepted accounting principles is to report the disposition or use made of all the funds management is responsible for,[3] these non-admitted assets should be included in the balance sheet.

---

[1]E. C. Wightman, Life Insurance Statements and Accounts (New York: Life Office Management Association, 1952) p. 61.

[2]Or in Page 4 of the 1962 Convention Blank which is reproduced in Appendix III.

[3]This does not imply the cash basis of Accounting but, instead, emphasizes the need for the accrual basis so that expenditures will be reported as soon as an obligation to pay is incurred.

Furthermore, if there is reason to believe that there has been any loss in connection with these expenditures, a contra-account (sometimes called a valuation reserve) should be set up so as to charge operations with the loss in the period in which it occurred. The contra-account is deducted from the asset cost so as to report the portion of the amount invested which is applicable to future operations. An example of this technique is the Provision for Uncollectible Accounts which is deducted from Accounts Receivable on the balance sheet. Bad debts expense is debited when the Provision is set up, thus charging the loss to the proper year.

Under the accounting procedure outlined in the preceding paragraph, both the present and future financial statements are conservative. The balance sheet is even more conservative under the insurance regulatory system, but, as will be demonstrated in connection with the discussion of the specific adjustments, future earnings statements are the very opposite of conservative. This is a matter of secondary concern to the regulatory officials in carrying out their supervisory duties since they must of necessity make evaluations based on measurement of the present legal surplus and technical solvency of the company. It is, however, a matter of deep concern to those interested in obtaining an accurate report by management of the status of the company as a going concern, both as to the amounts invested in assets which are used by the firm and as to the earning power which has been created.

The first group of adjustments which is attempted, therefore, is to place these non-admitted assets on the balance sheet and to set up appropriate provisions for estimated losses in connection with these assets.[1]

Adjustment 1. Supplies, stationery, printed matter

Most of the companies studied do not show either a ledger or non-ledger asset for the inventory of these supplies in Exhibit 13. Unless this is done, there is no way to obtain the data for an adjustment from the Convention Blank.

The accounting for supplies by insurance companies is not very different than the procedure used by many commercial firms. Many commercial firms also charge these supply items to expense when purchased. No objection is ordinarily made unless the amount is material. However, the amounts involved in the adjustments for those insurance companies which do inventory these items suggests that these supplies may at times be material.

Adjustment 2. Advances to agents or officers

These assets are not admissible, so must be eliminated from the assets in the Convention Blank balance sheet. They are reinstated with this adjustment.

---

[1]The mechanics of making these adjustments for the non-admitted assets are easy. These assets are eliminated in Exhibit 13 of the Blank, and the portion applicable to the current year is included in either Exhibit 4 or 14. Accurate adjustments can be made from the data in these exhibits. The adjustments are entered on the yearly worksheets and are proved by comparing the revised balances with the amounts shown in columns 1 and 2 of Exhibit 13. The success of this procedure proves the authenticity of the abbreviated analysis, used for companies G to V, wherein the adjustments are entered directly in Exhibit B without going through the laborious work sheet and proof of each balance.

The provisions for losses, by contrast, are done on a completely arbitrary basis. The methods used are discussed in connection with the individual adjustments.

Adjustment 3. Loans considered inadmissible

With the exception of a few special items, the Convention Blank either admits assets in full or eliminates them. Loans which do not meet the requirements for admission are therefore eliminated in the Convention Blank. They are reinstated with this adjustment. However, discussion is deferred to the chapter on analysis of individual companies so that reference can be made to the exact types of loans involved.

Adjustment 4. Agents' debit balances

The analysis of this item reveals important factors in the philosophy underlying insurance accounting.

Convention Blank requirements.--The review of the development of the Convention Blank in the preceding chapter indicates that the balance sheet in that blank is primarily a formula for computation of legal surplus. Much of the emphasis in the regulation of insurance companies centers around "impairment of capital." The Commissioners have accepted the idea of impairment of capital as a deadline over which a company must not be permitted to pass and remain in business.[1] Extreme conservatism has been the rule in determining impairment of capital, apparently under the belief that if Surplus is shown at the lowest possible reasonable amount and capital is not impaired thereby, the company is clearly solvent and can pay claims on the policies in force.

---

[1]See, for example, the address of E. E. Rittenhouse before the National Association of Insurance Commissioners in 1908. Proceedings of the Thirty-Ninth Session, page 204.

An agent can become indebted to a company in many ways. Some of the common ways include advances against future commissions; advances during a training period which are to be offset against future commissions;[1] failure to pay, within the time specified in his contract, the entire net amount of a premium due the company under a policy delivered to him; default in remitting company funds collected by him; improper incurrence of expenses on behalf of the company; and incurrence of an obligation to reimburse the company for medical and/or inspection fees which it had incurred on policies which he was unable to deliver.[2] In some instances, the amount of the debit balance may be clearly collectible, regardless of the personal fortunes of the agent. For example, the commissions on policies being processed may be more than the balance due from the agent. At the other extreme are balances due from agents who will shortly leave the company and never pay the amount due. Rather than attempt an evaluation of the collectibility of agents' balances, the insurance Commissioners require that all agents' debit balances be treated as non-admitted assets. This means the aggregate of all individual debit balances, not the net balance in the Agents' Account Control.

On the other hand, the aggregate of all agents' credit balances must be included in liabilities in the Convention Blank. These are as definite liabilities as would be the case if the indebtedness were to any other creditor or to a policyholder.

---

[1]Some companies are attempting to do away with schemes which put a new agent into debt to the company, which has to be repaid out of future production, but the practice is still not uncommon.

[2]Wightman, 168.

Evaluation and comparison with generally accepted principles.--Although the elimination of agents' debit balances from assets but the inclusion of credit balances in liabilities provide the regulatory officials with a conservative computation of surplus and leaves a safety margin in the computation of impairment of capital, it does not provide the type of reporting by management which stockholders are interested in. Stockholders should be informed about the total amount of company funds which are tied up in agents' debit balances and the estimated portion which will probably not be collected. Furthermore, the accounts which are uncollectible should be deducted as an expense in the earnings statement in the year in which the debit balance was incurred. The regulatory system reduces legal surplus by the entire amount of all debit balances when incurred, through the "Gain and Losses from Change in Value of Non-admitted and Related Items" accounts. When the balance is repaid, increase in legal surplus is shown. The regulatory system thus understates everything except liabilities in the year an agent's debit balance arises, and overstates earnings[1] in the year in which the balance is collected.

Mechanics of adjustment.--Adjustment 4 is designed to reinstate the agents' debit balances and eliminate the "Loss from Change in Value of Non-admitted Assets." In addition, a contra-account (valuation reserve) of 10 per cent of these debit balances is set up in Adjustment 30 for many of the companies. This 10 per cent is completely arbitrary, but is a demonstration of how provision can be made for the estimated losses on this

---

[1]These "earnings" are reported in the "change in non-admitted and related items" accounts in the Analysis of Surplus statement rather than as part of gain from operations.

type of asset. Naturally, each company would have to make studies to determine what portion of agents' debit balances are likely uncollectible in their own experience.[1]

An adjustment for agents' balances is made for every company studied. The significance of these adjustments can be seen in Exhibit II for each. In addition, noteworthy relationships are called to attention in the next chapter as the individual companies are discussed.[2]

---

[1]The 10 per cent contra-account is established for all of the national and domestic firms subjected to the abbreviated analysis, but for only those of the companies studied in detail which had not followed a rigorous policy of charging off accounts as soon as they became doubtful.

This policy regarding charge-offs had to be subjectively determined from the relationship between Recoveries on Accounts Previously Charged Off (memorandum on line 7.2 of Exhibit 5 of 1962 statement and the comparable line in other years) and the dollar amount of the charge-offs.

[2]The mechanics of making this adjustment seem confusing at first. Reference to the partial Convention Blank in Appendix III will show that the balance of the Agents' balances control account is entered on line 12.1 of Exhibit 13. This balance is the net of all balances, both debit and credit. This net balance is the amount which is eliminated in Column 3 of Exhibit 13. This same net balance is used on line 32 of Exhibit 14. However, the net credit balances are entered in Line 39 of Exhibit 14. The result is that the change in debit balances is given effect in the total of Column 3 of Exhibit 14, which is carried to the Changes in Surplus portion of Page 3.

The adjustment for the year is, then, the sum of Lines 32 and 39 of Exhibit 14, and is the change in aggregate debit balances. Had the detailed yearly worksheets not been prepared for those companies studied in detail, it would have been easy to neglect Line 39. The worksheets could not be proved if this error was made, and their use established the authenticity of the summary entry used in the abbreviated analysis.

Adjustment 5. Premium notes, etc., in excess of net value and other policy liabilities on individual policies

Not very many of the companies studied have this asset. When the company does accept such notes, the portion in excess of the value of the policy must be considered inadmissible. Since the insurance company could offset the value of the policy against the note in case of non-payment, premium notes are admissible up to the value of the policy.

Adjustment 5 reinstates the portion of premium notes which is inadmissible. If there is doubt about the collectibility of these notes, a contra-account (valuation reserve) should be set up in a manner similar to that used for estimated uncollectible agents' balances.

Adjustment 6. Insurance premiums paid in advance

Not many companies bother to compute prepaid fire and other insurance premiums probably because this asset is inadmissible, anyway. From the going concern viewpoint upon which generally accepted accounting principles are based, this asset is composed of expenditures for the future benefit of the business and should be shown as such. It is as much of an asset as cash with which to pay premiums which are due would be. That is, the position of the company is little different whether they have insurance premiums paid in advance, or have the cash on hand with which to pay them and also have the unpaid bill.[1] For those companies where the information was available

---

[1]At no time in the research for this paper was a suggestion encountered which considered the possibility of entering the pro-rata cancellation value of the policies as an asset in the Convention Blank. Yet, such a possibility would seem consistent with the procedure followed in the case of premium notes covered by Adjustment 5.

in the Convention Blank, the prepaid insurance premiums are reinstated to the balance sheet with this adjustment.

Adjustment 7. Bills receivable

No receivable, generally, is admitted to the Convention Blank balance sheet unless it is secured. Most of the examiners' reports itemize the composition of the Bills Receivable account. Many different types of unsecured receivables, and some rather unexpected items, are included. In most instances these items are proper assets from the going concern point of view so are reinstated with Adjustment 7. Where they are not, specific comment is made during the discussion of the company in the next chapter.

Adjustment 8. Foreign exchange

Assets and liabilities which are payable in currency of other countries have to be converted to equivalent American dollars at the free rate of exchange[1] in the preparation of the Convention Blank. The net adjustment is entered as an asset in the Convention Blank if a debit and as a liability if it is a credit. The change during the year is reported as a Capital Gain or Loss in Exhibit 4. Gains and Losses on the actual transfer of funds to or from a foreign country are also reported as Capital Gains and Losses, but on a separate line of Exhibit 4. Generally accepted accounting principles would require that these items be shown in the earnings statement.[2] However, from a going concern viewpoint, there would seem to be no

---

[1]As published in the annual book of Valuation of Securities published by the committee on Valuation of Securities of the National Association of Insurance Commissioners.

[2]AICPA Accounting Research Bulletin 43, page 113.

need to adjust assets being held permanently unless there is good reason to believe that a permanent loss has been incurred. AICPA Accounting Research Bulletin 43 recommends that "Fixed assets, permanent investments, and long-term receivables should be translated into dollars at the rates prevailing when such assets were acquired or constructed."[1] (emphasis added).

Adjustment 8 eliminates the adjustment for foreign exchange, thus reinstating the assets to the amount which has been invested in them. Since the only significant foreign assets of the companies studied were, so far as could be determined from the examiner's reports and the Convention Blanks, located in Canada there should be no permanent losses which should be recognized. Losses on assets in Cuba have, of course, been recognized and the assets eliminated from the balance sheet entirely.

Other non-admitted assets

There are several other classes of non-admitted assets involved in the individual companies, but they are peculiar to one or two companies only, so are discussed when those companies are analyzed.

GROUP II Adjustments: Reverse Adjustment of Securities to N.A.I.C. Values, Thus Returning Them to Amortized Cost

The decision to make this group of adjustments was not as easy as for the Group I adjustments. However, this turned out to be one of the most interesting groups of adjustments because it focused attention on factors which are being discussed in professional accounting circles concerning the valuation of assets generally, and may point to aspects which are often overlooked in those discussions.

---

[1]Page 113.

Regulatory requirements

The review of development of the Convention Blank and insurance accounting in Chapter II points out the naturalness of the assumption by the courts and the legal profession that assets should be inventoried at liquidating values in the computation of legal surplus and solvency. That discussion also supports the contention that the balance sheet in the Convention Blank is, in reality, simply a formula for computation of legal surplus. More of the insurance commissioners during the formative years of insurance regulation, probably had a legal background than an accounting background. It is likely, therefore, that these officials just assumed that assets would be included at liquidation values without making any specific inquiry into the matter or into accounting techniques used in commercial firms.

The development of the valuation rules pertaining to the Convention Blank has been traced in the first chapter of Harold G. Fraine's Valuation of Securities Holdings of Life Insurance Companies.[1] Professor Fraine's study lends credence to the presumptions stated in the preceding paragraph. He concludes that "The valuation of securities holdings of life insurance companies did not play an important role in insurance regulation prior to 1907. The insurance codes of the various states were then generally silent on the matter of valuation."[2] He suggests that "the National Convention of Insurance Commissioners (now the National Association of Insurance Commissioners) first became concerned about valuation in connection with the lack of uniformity in the market prices at which different companies were carrying the same

---

[1]Homewood, Illinois: Richard D. Irwin, Inc., 1962. Professor Fraine calls attention to the assistance of the investment research staff of the Life Insurance Association of America in the development of this historical material.

[2]Ibid., 2.

securities."[1] (emphasis added). The New York State Insurance Department, working with the Massachusetts department, developed a list of market prices which they made available to all departments. In 1910 a permanent committee was established by the National Convention, and this committee has issued an annual list of security values since that time. This volume naturally reflects stock exchange and over-the-counter market quotations for securities actively traded. In addition, the committee will assign a value, upon application, to any security not included in its annual volume.

Some might argue that the objective market data available from this Committee would make the use of market values permissible under generally accepted accounting principles. They could point out, for example, that institutions such as mutual funds state their security holding at the stock exchange and over-the-counter market quotations.

At the present time even the regulatory system does not, however, make very extensive use of market values for most insurance company assets. From the beginning, it was assumed that cost and market were the same for such assets as sound mortgage loans. Over the years, more and more of the securities have come to be carried at cost, or cost adjusted for amortization of premium and discount or depreciation.

The reasons for the departure from market value are clearly and concisely set forth in Fraine's book so there is no need to review them here, other than to make a general observation about the underlying cause. All of the departures from market value have been made in order to achieve stability of valuation and thus reduce fluctuations in legal surplus.

---

[1] Ibid., 3.

Radical temporary departures from market value were made during the Panic of 1907, World War I, and the Depression of the 1930's.

Under present rules, bonds which meet certain quality tests are stated at cost adjusted for amortization of premium and discount. Most of the bonds purchased by life insurance companies qualify for amortization under these rules. Preferred stocks which meet the tests laid down for quality are stated at what amounts to a five year moving average market value.[1] Common stocks alone must be stated at market value regardless of quality. Since the statutes of most states severely limit the investment in stocks, only a small portion of the assets of a life insurance company are stated at market today.

Generally accepted accounting principles

The discussions in accounting theory textbooks are in agreement as to the generally accepted accounting for investments by commercial and manufacturing firms. All agree that if the intent of the firm is that the assets are held temporarily and if the securities are readily marketable, they may be included in current assets. In this case, they should be shown at the lower of cost or market. However, this need not be done on an item by item basis, but only in regard to the entire portfolio. If the securities are held as long-term investments, they are traditionally shown at cost adjusted for amortization of premium and discount. However, serious declines

---

[1] Specifically, the statement value for the prior year (or cost if purchased during the year), plus one-fifth of the difference between this value and the current market price.

of a permanent nature should be reflected in the accounts. There is also general agreement that market values should be disclosed.[1]

The lower of cost or market is recommended for temporary investments which are included in current assets because these temporary investments are really part of the cash account. They should not, therefore, be stated at more than the amount of cash which can be realized upon sale. This is not a departure from the going concern to a liquidation postulate, but simply a recognition that the going concern intends to sell these assets as soon as it needs cash.

Adjustment 20. Bonds

As was pointed out above, bonds which meet certain quality tests are included in the Convention Blank balance sheet at cost adjusted for amortization of premium and discount. The determination of eligibility for amortization is made by the Committee on Valuation of Securities of the National Association of Insurance Commissioners and is published in their annual *Valuation of Securities*. Unless a bond is rated by the committee as being eligible for amortization, it must be shown at market value. In general, bonds not eligible for amortization include those in default as to principal or interest, income bonds, perpetual bonds, and those not in the first four ratings by accredited rating organizations. An alternative to qualification via rating organization is provided through a battery of

---

[1] Finney and Miller, *Principles of Accounting-Intermediate*, p. 296-297; Welsch, Zlatkovich and White, *Intermediate Accounting*, p. 463; Meigs, Johnson and Keller, *Intermediate Accounting*, p. 223; Holmes, Maynard, Edwards and Meier, *Intermediate Accounting*, p. 330; Paton and Paton, *Asset Accounting*, pp. 139-141.

stipulated tests which include such computations as number of times interest is covered and the ratio of debt to total capitalization.[1]

Bonds owned must be tabulated in detail in Schedule D of the Convention Blank.[2] Column 13 of that schedule requires an indication of whether or not each issue is eligible for amortization. Before the adjustments for bonds could be made, it was necessary to analyze carefully the exact nature of the bonds which were identified as not eligible for amortization in that column. That analysis indicated that the bonds which failed to qualify often showed considerable change in market value from year to year, but were seldom bonds which would probably not be paid at maturity. Where this appears true, the bonds are reinstated to amortized cost in Adjustment 20.[3]

---

[1]Exact requirements are set forth in a pamphlet _Valuation Procedures and Instructions for Bonds and Stocks_ published annually by the Committee on Valuation of Securities. Summaries can be found in Charles M. Beardsley, _Life Company Annual Statement Handbook_ (Winston-Salem, North Carolina: The author, 1962), p. V-64 and Harold G. Fraine, _Valuation of Securities Holdings of Life Insurance Companies_ (Homewood, Illinois: Richard D. Irwin, 1962), p. 13.

[2]The extent of detail required can be visualized from the consolation offered by Beardsley on page V-56: "It is not necessary to list every individual bond owned by the Company. All those bonds having the same issuer, same maturity date and same interest rate may be grouped together on one line, even though they have been purchased at various dates."

[3]In many cases, the appropriate adjustment is the total of columns 1, 3 and 5 of Exhibit 4--Capital Gains and Losses. However, this is not always true since there is a diversity of practice between companies in regard to the method of handling amortization and the computation of gain and loss upon sale of bonds. (As was noted earlier, there is no prescribed accounting system. The only requirement is that the Convention Blank be satisfactorily filled out.)

Considerable research time was required at the start of the study of each company (both those analyzed in detail and those subjected to the abbreviated analysis) to see if the adjustment based on Exhibit 4 really gave an adjusted balance equal to amortized cost. The examination reports were often helpful in reconstructing company procedure.

Absolute certainty that every issue was adjusted to amortized cost was not achieved for the larger firms with huge bond portfolios, but the degree of possible error would be so minor as to be immaterial.

The balance sheet which is prepared for each of the companies studied in detail thereby shows the market value in a memorandum column, and the effective amount invested in bonds is the primary figure. This is consistent with the pattern recommended throughout this study.

Adjustment 21. Stocks

As is noted above, common stocks have to be shown at market value in the Convention Blank balance sheet, and qualified preferred stocks at a five year moving average of market price. Non-qualified preferred stocks are shown at current market value.

During the period covered by this study, most common stocks have risen in market value. This has resulted in an increase in assets and in "Capital Gains," reported in the statements of life insurance companies. Interestingly, the resulting "Capital Gain" is reported in the Surplus Account section of the Convention Blank rather than in the Operating section.

Data "hidden" in Convention Blank detailed schedules.--One of the significant aspects of the Convention Blank is that there is a wealth of significant data in the blank, but this information is available to only those experts who have ready access to the blank and know where to find the details within the blank. This is well illustrated by the way capital gains and losses are handled. The amount entered in the Surplus Account section is supported by a schedule (Exhibit 4) which tabulates the amount of gain from each source--bonds, stocks, etc.--and breaks each down according to the portion resulting from actual sale, from change in market value of securities still owned at the end of the year, and from changes in book value. This exhibit contains a summary which breaks capital gains and losses into two categories: (1) realized and (2) unrealized. This breakdown

is designed to provide precise information as to the portion of capital gains resulting from sale of securities and the portion resulting from changes in the market value of the securities still owned. However, this information does not appear in those annual reports to stockholders or data in financial reporting services which are based on the first four pages of the blank. Although some companies show the realized and unrealized portions separately in a summary of changes of surplus in their annual report to stockholders, the practice is far from universal. Of the 45 reports to stockholders or policyholders obtained for 1962 as one of the preliminaries to this study, only 11 make a clear-cut segregation.

Diversity of practice.--A further problem exists in regard to computation of realized and unrealized capital gains shown in the Convention Blank. There is a wide diversity of practice among companies. No official instructions are given as to the specific items which belong in each classification, but the company is asked to explain the method it uses.[1]

---

[1]The extent of the lack of agreement among companies is evident in the "Digest of Informal Discussion" of the Transactions of the Society of Actuaries, Meeting Number 8 (1952), pages 131-144. A few random quotations illustrate the diversity of opinion: Mr. William Chodorcoff reported that "The Prudential assumed that the terms referred to the results of the year and that realized gains or losses arose only on asset dispositions during the year. The amount of realized net gain was taken as the difference between the net consideration received and the asset value at the beginning of the year, adjusted for the current year's amortization or depreciation to date of disposition." (emphasis added).

Mr. L. H. McVity is reported to have observed that "one formula for 'realized' capital gains is to use the net profit or loss from sale or maturity. This formula would result in a company never showing a realized loss from the original book value of an asset which was marked down in a previous year but which was sold in the current year at a price somewhere between the marked-down price and the original book value."

Mr. G. M. Crowley reported that "The 1951 statements of 22 leading companies showed that 11 companies took gross profits less gross losses

Gains and losses on securities sold are computed in Schedule D-4 of the Convention Blank (detailed list of all bonds and stocks sold, redeemed or otherwise disposed of) and carried in total to the summary of capital gains and losses in Exhibit 4. Schedule D-4 contains a space for both the cost of the security to the company and the book value at the date of sale.

---

on sale or maturity as the measure of realized gains; 3 also included increases less decreases in book value; and 8 used special bases, no two of which appeared to be exactly the same. One company took $4 millions set aside for the new security valuation reserve as an unrealized capital loss."

The 1951 Convention Blank included realized capital gains in the operating section, but unrealized capital gains were reported directly in the Summary of Changes in Surplus. After that one year, both types were included in the Summary of Changes in Surplus only.

Current practice, as revealed by analysis of capital gains in the companies whose statements are adjusted to agree with generally accepted accounting principles in this study, is nearly as diverse as when the split between realized and unrealized gains was introduced in 1951. Specific comments are made in connection with the analysis of the individual companies.

The only specific instructions uncovered in the course of research are in Beardsley. On pages III-72 and 73 he observes: "A company may apply its own interpretation....However, for most life insurance companies it is believed that the method used by Model Company (the example in the manual) will be appropriate.

"The gain or loss realized on sale or maturity of investments is the arithmetic difference between the total of Columns (2) and (4). Usually, however, all of such gain or loss cannot be attributed to the current year only, particularly in the case of stocks. Therefore there is an adjustment to modify this difference by any net gain or loss which might have been included but which is not attributable to the current year.

"The problem involved here can be illustrated by a simple example of the distortion which might take place if the gains of previous years are not recognized as such. Assume that a company has capital gains only in stocks. Say the market value of stocks over the book value at the end of the prior year is $100,000. If, in the current year, the Company should sell the particular stocks which account for this difference in value, and there are no other changes in the stock portfolio or its market value, then Exhibit 4 in the current year will indicate a profit of $100,000 in Column (2) and a loss from change in difference between book and market value of $100,000 in Column (5). The net gain in Column (6) will be zero.

According to Beardsley, the gain or loss is to be computed from the book value at the date of sale rather than from the cost of the stock. In many instances, the cost and book value at the date of sale is the same, but there are firms which make adjustments to book value of stocks, and, as a result, the gain or loss reported is not the difference between cost and selling price. Specific examples will be pointed out in the discussion of the individual companies in the next chapter.

What adjustment 21 attempts to do.--In order to provide the type of accountability information upon which generally accepted accounting principles are based, an attempt is made to return the common stock account to cost in adjustment 21. Market value is shown in the proposed balance sheet, but as a memorandum figure only as far as assets are concerned. This memorandum figure is, however, used in the computation of legal surplus.

Adjustment 21 also provides for computation of the gain or loss on sale of stock as the difference between the consideration received and the cost of the stock. This is the gain which became available to management in the form of funds which could be applied to alternative uses, and

---

If Line 11 considers only the total realized gain, and not the fact that the excess of market value over book value was accumulated in previous years, it will show as $100,000 and Line 12 will show an unrealized loss of $100,000. Clearly these are not the facts as they should be presented.

"For this example, Line 11 should be completed to show $100,000 realized gains on assets disposed of during the year, less $100,000 reflected in previous years, or a net of zero for the year. Line 12 should show net unrealized gains of $100,000.

"To obtain the amount of gains reflected in previous years' statements a company will calculate the excess of market value over book value on January 1 of the current year for any securities later sold during the year...."

should be accounted for as such, rather than be merged with changes in the market value of securities still owned. Prior to the time a security is sold, management decisions are of a different nature and relate to the opportunity to sell the stock and realize a gain or loss. A decision to hold the security rather than sell should be as carefully reflected in the accounts as the gain on a sale. The proposed balance sheet permits management to report both of these aspects.

Adjustment 22. Mortgage loans

This adjustment applies to only a few of the companies studied, so is discussed in the next chapter at the same time those companies are reviewed.

Adjustment 25. Change in Capital Gains As a Result of Other Adjustments in This Group

Most of the adjustments in this category result from the situations described in the discussion of Adjustment 21. In the case of the abbreviated analysis, the amount entered as Adjustment 25 is, in some cases, the amount necessary to keep the balance sheet adjusted figures in agreement with the cost data in detailed Schedule D of the Convention Blank. The proofs worked out in the annual worksheets for the companies analyzed in detail indicate that this is a reasonable presumption.

Group III Adjustments: Provide for Possible Losses on Certain Assets

This group of adjustments is primarily demonstrative in nature. They are used to demonstrate the generally accepted accounting technique of providing for estimated losses which experience has proved exist but which cannot be specifically identified. For example, experience would undoubtedly

indicate that some portion of agents' debit balances would not be collectible. As was noted in connection with the discussion of Adjustment 4, 10 per cent of agents' debit balances is arbitrarily set up as a provision for estimated losses for many of the companies. Naturally, an insurance company using this procedure in practice would have to devise a method of estimating the probable uncollectibles which fits its own situation. One possibility might be a five year moving average of uncollectibles as a percentage of either total debit balances or volume. Any such scheme must, however, be reappraised periodically to be sure it fits current conditions.

The type of adjustment made in this group could be used for any asset where there is a loss which should be charged to expense in a current period in order to obtain accurate matching of revenues and expenses, but the specific individual asset which will suffer the loss cannot be identified. Some illustrations are given in the discussion of the individual companies in the next chapter.

Group IV Adjustments: Defer a Portion of Acquisition Costs to Future Periods

This group of adjustments brings to light one of the principal differences between the generally accepted accounting developed for commercial and manufacturing concerns and the insurance accounting required by the Convention Blank. The basic problem involved in acquisition costs is recognized in both, but the approach to the handling of the problem is totally different.

The problem

Life insurance policies are contracts extending over a considerable period of time, commonly a person's lifetime. Financial reports, on the

other hand, are prepared annually. This alone poses an almost insurmountable problem. However, the problem is made even more difficult by the fact that a large portion of the costs of an insurance policy are incurred during the first year. Not only is the first-year commission substantially higher than renewal commissions, but the underwriting costs such as physical examinations, policy costs, establishment of policy and accounting records and other overhead costs are largely incurred in the first year.

Insurance companies are required, in completing the Convention Blank, to charge all of these costs to expense when incurred. This is in line with the concept of admitted assets. However, the effect on the legal surplus of a newly organized or rapidly expanding company can be disastrous. Estimates of first-year costs vary widely, but nearly all estimates are for amounts substantially in excess of the first-year premium.[1] Thus, even before provision for reserves each new policy shows a loss in the first year and causes a reduction in Legal Surplus as computed in the Convention Blank. A new company can completely deplete what appeared to be an adequate original surplus if it is able to write a substantial volume of insurance before the "profit" from renewal premiums is large enough to offset the "loss" on first-year business.

---

[1]For example, Laurence F. Lee testified before the Senate Finance Committee in 1958 that "it takes approximately $1.45 to put on a dollars worth of new business." Taxation of Life Insurance Income - Hearings Before Committee on Finance, United States Senate, on H. R. 10021, 85th Congress, second session, March 5 and 6, 1958, page 118.

The following comment from Dan M. McGill, Life Insurance (Homewood, Illinois: Richard D. Irwin, Inc., 1959) p. 268 is typical of the comments in textbooks: "The costs of acquisition are such that the first year expenses greatly exceed the loading in the first year gross premium. Indeed, under many policies, first year expenses will exceed the entire gross premium."

The Insurance Industry Solution - Preliminary Term Reserve Methods

In recognition of this problem, the insurance industry has developed a system of modified preliminary term reserves. The effect of these methods is to reduce the amount of reserve which has to be set up at the end of the first year below what it should be under the level premium concept. This in turn permits a large portion of premiums to be included in revenue in the first policy year to partially compensate for the high initial expense. Larger amounts are transferred to reserves in ensuing years than would be required under net level premium plans, thus gradually bringing reserves up to level premium standards.

Justification.--This solution may seem strange to the accountant who is used to dealing with commercial and manufacturing firms until he

---

In an earlier chapter, McGill works out an example using first-year costs as 115% of first-year premiums, with a footnote warning that first-year commissions in a small company are usually 60 to 80 per cent of gross premiums whereas 55 per cent is assumed in his example for commissions and 60 per cent for other expenses. (p. 245).

The examiners report on file in the Nebraska Insurance Department on one medium-sized mutual company includes a summary of studies of the costs of acquiring ordinary insurance conducted by that company for internal purposes. That study shows:

	1959	1960	1961	1962
Cost per thousand dollars of ordinary insurance:				
Administrative costs, including service and overhead expenses	$19.99	$20.20	$20.41	$19.31
First year commissions and training program allowance	13.70	13.61	14.65	14.25
Total cost	$33.69	$33.81	$35.06	$33.50
Average first year premiums per thousand dollars of ordinary insurance	$20.03	$19.42	$20.29	$20.04

remembers that (1) the Convention Blank balance sheet is primarily a formula for computation of legal surplus, (2) only readily salable or collectible assets which qualify as legal investments of insurance reserves may be included in that balance sheet, (3) the development of the Convention Blank has been in large measure the responsibility of actuaries, who are vitally concerned with valuation of policy reserves, and (4) experience has shown that there is a select period in the first years of a policy during which, due to selection of risks through physical examinations and other means, death claims are relatively few. The next few paragraphs summarize the reasoning by which these concepts are used by the insurance industry to justify modified preliminary term reserves.

If the balance sheet is only a formula for computation of legal surplus, it makes no difference whether a factor is added to assets or subtracted from liabilities. Since the items which can be included in assets are severely limited, actuaries naturally look to liabilities as a means of achieving proper measurement of surplus. Reserves are the largest liability and, contrary to liabilities in a commercial enterprise which are usually definite in amount, are mathematical estimates based on assumptions regarding mortality and interest.[1] A helpful concept, but one subject to technical qualification, is that insurance reserves are the portion of premiums which, because of the level premium method of paying

---

[1]A technical definition on page 583 of Robert J. Mehr and Robert W. Osler, _Modern Life Insurance_ (3d ed.; New York: The Macmillan Company, 1961) reads: "The reserve is a liability representing that amount which, together with future net premiums and interest will be exactly sufficient to enable the company to meet all policy obligations as they fall due, assuming that the company's experience is precisely in accordance with its assumptions relating to mortality and interest."

for insurance protection, are paid in advance during the early years of a policy. These advance payments, together with the interest thereon, offset the higher premiums which would otherwise be due in the later years of the policy if premiums were paid in accordance with expected mortality year by year. Care must be taken, however, to recognize that the reserves are not allocated by bookkeeping entry when premiums are received on individual policies but are, instead, placed on the financial statements by an adjustment process based on computations involving aggregates applied to mortality tables approved by the state.

The real factor which the computation of legal surplus, or technical solvency, is supposed to measure is the ability of the insurance company to pay all claims as they come due. Those who support modified preliminary term reserves argue, consequently, that any reserve system which gives reasonable assurance of this ability should be satisfactory. Not only is there a select mortality period in the first years of a policy during which deaths are lower than shown in the ultimate mortality tables prescribed by statute, but the mortality tables have a built-in safety factor. That is, the assumptions as to the rates of interest, mortality, and expense used in calculating the reserve are substantially less favorable than those actually expected.[1] The reserves are consequently greater than would be required to meet all future obligations on the basis of realistic assumptions. Policyholders are, therefore, adequately protected even though part of the reserve is temporarily "borrowed" during the first policy year, so

[1]Joseph B. Maclean, Life Insurance (New York: McGraw-Hill Book Company, Inc., Ninth edition, 1962) p. 127.

long as the system brings the total reserve up to the net level premium standard by the time the advance payments of the early years are needed.[1]

The landmark court case[2] involving preliminary term insurance reserves was decided after calling on prominent actuaries for expert testimony. The court concluded that since this method of reserve computation involved merely a postponement of the accumulation of the required reserve, it involved no danger to the solvency and safety of the company. Considerable weight was given to two public policies. First, the court noted that the company involved was a foreign company which had applied for a license in Vermont, and suggested that it was highly desirable to have insurance risks distributed as widely as possible by admitting companies which had met the requirements of their home states unless clearly not qualified under Vermont statutes. Second, the court was concerned that the valuation rules not be interpreted in such a way as to give a monopoly of the life insurance business to established companies by applying a rule which would make it impossible for a new company to survive. The court also paid considerable heed to equity between old and new policyholders and argued that new policyholders should stand their own acquisition costs insofar as possible through lower policy reserves.

Actuarial justification centers around the fact that a mathematical assumption that "loading is just sufficient to cover expenses" is made in computing net level reserves. Further, the computations imply that "since

---

[1]McGill, pages 270-275 used the idea of "borrowing" to explain the idea of preliminary term valuation.

[2]Bankers Life Insurance Co., vs. Howland (1900), 73 Vt. 1, 48 Atl. 435.

the loading is the same every year, the expenses are the same." These assumptions are not, of course, in accord with the facts.[1] Since loading is the difference between the gross premium and the net premium[2] a modified system with a lower net premium reserve requirement in the first year also means a higher loading that year. This, they point out, brings loading closer to actual expenses.

Full preliminary term reserves.--The original reserve method using the modified reserve concepts is known as the full-preliminary-term method. The essential feature is that no reserve is required at the end of the first year. For purposes of calculating reserves, the policy is looked upon as a one-year term life insurance policy for the first year. Thereafter it is regarded as the original policy, issued one year later, for a period one year shorter.[3] For example, a twenty-payment life insurance policy issued at age 35 is regarded as a one-year term life insurance policy at age 35 plus a nineteen-payment life insurance policy issued at age 36. The entire first-year premium is thus taken into revenue to offset the high first-year costs. The reserve is started the second year and is gradually brought up to what it would have been under full level premium reserve computations so that the two are equal by the end of the premium paying period.[4]

---

[1]Robert G. Larson and Erwin A. Gaumnitz, Life Insurance Mathematics (New York: John Wiley & Sons, Inc., 1951) p. 100.

[2]Allen L. Mayerson, "Dividends: Life Companies," Ch. 12 in Vol. 3 of Examination of Insurance Companies, Adelbert G. Straub, ed. (New York: New York Insurance Department, 1954) p. 615.

[3]Mehr and Osler, page 588.

[4]Care must be taken not to let the title of this method give a false impression. The policy is not a term policy during the first year. All that is involved is that the reserve is established as though it were a term policy the first year.

Modified preliminary term reserve methods.--Very few states authorized the unrestricted application of the full preliminary term method for all policies. Analysis showed that it is both justifiable and practical for ordinary-life policies but not for endowment and other "high-priced" plans.[1] Several modified preliminary term methods were developed, but the plan known as the Commissioners Reserve Valuation Method, and embodied in the Standard Valuation Law, has been adopted by all of the states and is the minimum reserve applicable to most ordinary insurance issued since December 31, 1947.[2]

The details of the Commissioners Reserve Valuation Method are complicated, but the essential feature is that for policies under which the premium is not greater than that for a 20-payment-life policy, the full preliminary term basis is permitted, while for policies with a premium higher than for a 20-payment-life policy a partial reserve must be set up at the end of the first year. The full reserve must be accumulated by the end of the premium paying period.

Extent of Use.--One of the significant aspects of the modified preliminary term reserve methods is that they have been generally adopted by only the new and smaller firms where the dollar amount of surplus is a problem. Maclean, former vice-president of one of the largest life insurance companies and a highly respected actuary, points out in his text that because of their substantial surplus funds and large volume of renewal business, the larger and older companies are well able to finance new

---

[1]Maclean, pp. 132-136.

[2]McGill, p. 280.

business on the full net level premium reserve plan. Consequently, practically none of the large, strong and well-established companies have adopted the Commissioners Reserve Valuation Method, even though "it would be entirely sound, logical, and realistic" for them to do so.[1]

The Select and Ultimate Plan.--A plan which is based on another aspect of reserves is pertinent to this study even though it is not now used. This plan was devised by the consulting actuary to the Armstrong Committee, and was incorporated into the New York Insurance Law in the general revision which followed the Armstrong Investigation. It is known as the Select and Ultimate method and is based on the fact that the mortality tables used in establishing premiums and net level reserves are all ultimate tables. That is, these tables ignore the fact that during the first years of a group of policies death claims will be less than for a similar group of the same ages which had been purchased several years earlier. This stems from the elimination of poor risks in the process of selecting life insurance policyholders. A select mortality table, by contrast, takes this factor into account and shows expected mortality by duration of insurance as well as by age. The use of select tables would unduly complicate the computation of premiums and reserves so are not used.

Even though death claims followed the mortality tables, there would still be mortality savings during this select period since premiums are based on ultimate tables. The select and ultimate method takes cognizance of this and permits a reduction in reserves during the first five years of

---

[1]Maclean, Life Insurance, p. 140. Since the Standard Valuation Laws specify minimum reserves, there is no legal objection to use of full net level or any other approved method of reserve valuation which provides larger reserves than the minimum.

a contract equivalent to the present value of the anticipated mortality savings. By the end of five years, the full net level premium reserve must be accumulated and must be maintained thereafter. However, experience proved that, while the method is actuarily sound, mortality savings during the five-year period are not adequate to absorb first-year expenses.[1]

The solution indicated by generally accepted accounting principles

A different set of criteria must be met by statements prepared in accordance with generally accepted accounting principles. The goal is not just the computation of legal surplus, but, instead, an accounting for the funds which have been made available to management and fair measurement of how well management has used these funds. This use of funds involves both expenditures which have been made for the benefit of future periods and the amount of profit which has been realized.

Under generally accepted accounting principles, it makes a great deal of difference whether an asset is omitted or a liability understated. Two wrongs do not make a right in this respect, even though the same surplus figure is obtained.

As was pointed out in the chapter on historical development, the income statement has assumed first place ahead of the balance sheet in the financial statements of commercial and manufacturing firms. One reason for this is that the income statement gives some indication of the earning power which has been generated. In order for the income statement to be an effective means of measuring and communicating this earning power, a proper matching of revenues and expenses must be attained. The general

---

[1]McGill, p. 284.

approach has been to take revenue up in the income statement when it is realized and to then deduct as expense the costs which were incurred in order to obtain that revenue. Expenditures which are applicable to future revenue are carried as assets until that revenue is realized. For example, the cost of a machine is considered an asset. This cost, net of expected resale value at the end of its useful life (salvage), is allocated to expense (depreciated) over the time that machine is used in the business, thus matching the appropriate cost of owning the machine against the revenue which that machine helps generate.

In theory, there is little difference between the cost of acquiring a machine which will be used to help generate income over a twenty-year period, and the cost of acquiring an insurance policy which will bring revenue into an insurance company over a twenty-year period. The fact that the machine is more readily salable has little bearing on the fact that the expenditure involved is an asset, although it might be noted in passing that it is not impossible that an insurance company might be able to realize more on an insurance policy through reinsurance than a manufacturing firm could get for a special purpose machine. The manufacturing firm would not write the special purpose machine down to what it could get in a forced sale of that machine, but would allocate the cost against the revenue which the machine helped to generate. Ideally, the cost of acquiring an insurance policy by a life insurance company should be handled in the same way.

Life insurance is not the only industry which has difficulty with acquisition costs. For example, some oil production companies charge oil exploration costs to expense, and some even charge the intangible drilling and development costs of producing wells to expense. However, these

practices stem, not from a failure of theory to recognize these items as assets, but from statutory provisions which permit them to be deducted as expenses in computing Federal income tax. Furthermore, increasing concern is being brought for improvement. At least one of the national public accounting firms has made a plea for insistence on capitalization for accounting purposes even though these items are deducted for tax purposes. Arthur Andersen & Co. has taken the viewpoint that "the income-tax statutes and regulations are not intended to and do not necessarily establish sound accounting principles for financial reporting purposes."[1]

Nature of the adjustments made

In order to obtain a reasonable matching of revenues and expenses, it seems essential that the acquisition costs of insurance policies be spread over the time revenue will be received from those policies. An accurate adjustment would, of necessity, have to be based on records which only the insurance companies have, and would, even then, be time-consuming if not impossible, retrospectively. It is believed, however, that an arbitrary adjustment, which admittedly is not sufficiently accurate for practice, can give some test of the significance of capitalizing these acquisition costs and of the materiality of the effect on annual earnings. If the results are significant and material, further research is indicated to see if there are practical ways of capitalizing these costs and allocating them to annual fiscal periods fairly. Such methods would likely require the use of automatic data processing equipment.

---

[1] Accounting and Reporting Problems of the Accounting Profession (The company, second edition, October, 1962) p. 103.

Adjustment 40. First-year Life Insurance Commissions

Why a five-year period was selected.--The adjustment made for first-year life insurance commissions is completely arbitrary. Certain traditions and factors of recognized standing by the insurance industry lend support to the five-year period used, however. First, there is general agreement among actuaries that, although the effect of selection of risks may be felt for fifteen years or longer, the significance wears off after approximately five years.[1] Not only was a five-year period used in the Select and Ultimate reserve plan, but a five-year period is given indirect effect in computing policyholder dividends under the Contribution method used today. Maclean points out that this contribution method, in one or another of its modifications, is used by practically all companies in the United States and Canada.[2] He goes on to explain how the select period enters into the dividend formula with this observation:

> The mortality factor of the dividend in the three-factor contribution formula is . . . normally a percentage of the "tabular cost of insurance," i.e., of the contribution to the current year's death claims which would be required if the actual rates of mortality experienced were those of the mortality table used for premiums and reserves.
>
> . . . It is also usual to base the percentages on the *ultimate* mortality experience, i.e., to eliminate the experience under the policies which have been less than 5 years in force. The *extra* mortality savings under recently issued policies is not usually reflected in their dividends but is considered as an offset against the *extra* expense of the first year.[3]

In one of his widely cited actuarial studies, Maclean elaborates further with the observation that, in effect, the use of ultimate rather than select

---

[1]McGill, p. 141.

[2]Maclean, p. 148.

[3]*Ibid*., 155.

mortality tables in the computation of dividends means that the insurance industry has adopted the convenient rule that select mortality profit shall be applied toward payment of expenses and not be included in dividends to policyholders.[1] Since dividend computations are not controlled by statute, it seems reasonable that the method chosen by trained actuaries as a fair method of allocating costs against policies for dividend purposes is likely a fair method for accounting and reporting purposes also.

The five-year concept is given further recognition in Great Britain. Dividends are computed only once every five years by most British companies.

A second factor which reinforces the use of a five-year period is that it is desirable to use a relatively short period in testing the significance of the adjustment. If significant results are obtained over a five-year period, the results must be highly significant if the acquisition costs were spread over the entire premium paying period of whole-life and limited-payment policies.

A third factor which suggests use of a short period of allocation is that the lapse rate is much higher during the first year or two than thereafter. In any actual application on a policy by policy basis, the unamortized acquisition costs on a lapsed policy would have to be charged to expense in the year of lapse. It is quite possible that the combination of modified preliminary term reserves with their high portion of premiums taken into revenue in the first policy year plus a short period of allocation of first-year commissions to expense gives adequate consideration to the lapse rate in the arbitrary formula used in this study.

---

[1] Joseph B. Maclean and Edward W. Marshall. Distribution of Surplus (New York: Actuarial Society of America, 1937) p. 34.

A fourth, but important, factor is that no adjustment is being made in this study for acquisition expenses on life insurance policies other than first-year commissions. To some extent, the modified preliminary term reserve methods can be considered as doing an equitable job of allocating all acquisition costs other than first-year commissions over the premium paying period of the policy. Since renewal commissions are ordinarily paid over a nine or ten-year period, with occasionally a service fee thereafter, these commissions are already reasonably allocated over a fairly long portion of the premium paying period. If first-year commissions are then amortized over a five-year period during which there is a select mortality saving, the over-all effect might be fairly reasonable as compared to a scientific policy by policy allocation.

Warning as to arbitrariness of the adjustment.--Warning has already been sounded that this adjustment is arbitrary, but the point is so important as to justify re-emphasis. The purpose of this adjustment is to test the significance of capitalization of direct acquisition costs and amortization over the premium paying period of the policy. If such an adjustment, made on an arbitrary but highly conservative basis, is significant, further research at the company level is called for.

Opinion of actuaries and insurance accounting specialists.--Several actuaries and CPA's who specialize in insurance work volunteered the off-hand opinion, when the proposed adjustment was discussed with them, that an over-adjustment is definitely being made for those companies which use the modified preliminary term reserve method of valuing all of their policies, and that an under-adjustment is likely for the well-established firms which have most of their policies valued under the full net level plan.

Effect of reserve method used.--Although investigation of a scientific policy-by-policy allocation is beyond the scope and purpose of this study, an observation is in order. An accurate computation of the amount carried as an asset at the end of the first policy year would have to be based on the reserve method used. If the entire acquisition cost were set up as an asset on the date the policy is issued, a larger portion should be allocated to expense in the first policy year than in later years when a modified preliminary term reserve system is used. The same effect could be obtained where the asset is set up by adjustment at the end of the year by establishing the asset at that time as the excess of acquisition cost over the portion allocable against the premium taken into revenue that year. In this way, the effect of the modified preliminary term reserves on legal surplus would not be affected. The over-adjustment which actuaries see in this study would be eliminated.

Adjustment 41: Accident and health insurance commissions

This adjustment, too, is arbitrary and would require detailed research at the company level before it could be applied in practice. However, it is undoubtedly more accurate than the adjustment for first-year life insurance commissions.

Although there are several kinds of policy reserves relating to accident and health insurance, the most significant from an accounting aspect is the unearned premium reserve. This reserve is based on the total contract or gross premiums paid,[1] rather than on the net premium used in the valuation of life insurance reserves, and is simply the pro-rata

---

[1]Mehr and Osler, p. 597.

portion applicable to the period from the date of valuation to the next following renewal or premium due date. Some companies find that a reserve of 50 per cent of the gross premiums is sufficiently accurate. However, when premiums are paid on less than an annual basis, a semi-monthly or other more accurate method is used.[1]

The actuary for one medium-sized company which specializes in accident and health insurance pin-points both the accounting problem and the philosophy of the insurance industry solution when he observes that, although state statutes require a gross premium reserve, a pure-premium reserve plus a reserve for the administrative expense that will be paid during the unexpired portion of the contract term would be a more accurate measure of the insurer's liability. When the reserve is based on gross premiums no allowance is made for the commissions, other acquisition costs, and expenses that are paid when the contract is issued. He contends that on first-year premiums, these expenses may be as much as 40 to 50 per cent of the premium. In renewal years they will be closer to 35 per cent. As a result, he estimates that most insurers have an equity of 20 to 35 per cent in their unearned-premium reserves, which equity acts as an extra margin of safety.[2]

Instead of reducing the liability, as suggested by Angle, generally accepted accounting principles suggest that the extra acquisition costs should be set up as an asset and amortized over the period of time revenue will flow in as a direct result of these expenditures. However, since

---

[1]G. F. Michelbacher, Multiple-line Insurance (New York: McGraw-Hill Book Company, Inc., 1957) p. 127.

[2]John C. Angle, "Reserves," Chapter 12 in Edwin J. Faulkner Health Insurance (New York: McGraw-Hill Book Company, Inc., 1960) p. 410.

many accident and health policies are in effect one year policies, accountants would likely go along with the conservative procedure of allocating the costs over the policy year. The adjustment made in this study approximates such an allocation.

The Convention Blank contains a special schedule (Schedule H) which analyzes accident and health business in detail. The amounts involved in Adjustment 41 are taken from that schedule. The net commissions for the year as shown on line 28(d) of Schedule H are multiplied by a fraction, the numerator of which is the unearned premium reserve shown on lines 45(a) and 45(b) and the denominator of which is the premiums written or renewed during the year shown in line 7 of that schedule.[1] The product is the balance to which Deferred Accident and Health Insurance Commissions is adjusted.

Adjustment 42. Accident and health insurance direct acquisition costs

The accident and health insurance analysis which comprises Schedule H of the Convention Blank asks for the total "acquisition and field supervision expenses (other than commissions)" on Line 29. The same portion of this line is deferred as in the case of commissions.

Some companies include only a few types of expenditures on Line 29. However, some companies include substantial costs.

No adjustment corresponding to Adjustment 42 is made for life insurance. The reason for the different treatment is that life insurance reserves in

[1]A more accurate computation might use the pro-rata portion of the policy period as the numerator of the fraction, but this would involve a policy by policy computation whereas the computation used in this study can be taken directly from Schedule H.

all except the large, well-established companies are usually based, in full or in part, upon the modified preliminary term concept. Traditionally, accident and health insurance reserves have not embodied this modification although the report of a special Task Force recommending permission to use a two-year preliminary term method of valuation for certain types of policies of the guaranteed renewable type, was adopted by the National Association of Insurance Commissioners in 1954.[1] As have been previously noted, it is assumed that the extra portion of life insurance premiums taken into income in the first year under modified preliminary term life insurance reserves offsets the extra costs other than commissions. Except for a few types of policies, no similar modification of reserves is made in the case of accident and health policies, so it seems desirable to defer the appropriate portion of at least the direct field supervision and acquisition costs which can be identified.

Other costs deferred

Some of the companies studied have special situations in which costs need to be deferred in order to make the financial statements agree with generally accepted accounting principles. These items are discussed in connection with the analysis of the individual companies.

Group V: Place Non-admitted Fixed Assets on the Statements and Carry All Fixed Assets at Amortized Cost

As a general rule, most life insurance companies report real estate at cost less depreciation, but charge other fixed assets to expense when acquired. Many states have recently started to allow capitalization of

---

[1]Angle, p. 419.

electronic data processing equipment. This treatment is often limited to equipment costing more than some specified amount, commonly $25,000, and is subject to a ceiling such as 2 per cent of admitted assets.[1]

The official instructions do not require that real estate be carried at cost less depreciation, but, instead, limit the maximum value which may be admitted to that figure. Apparently, if current market value is less than depreciated cost, market value should be used in the Convention Blank. The specific practices of the companies studied reveal more than the official instructions and the literature regarding actual practice. These individual practices are discussed in connection with the analysis of the individual companies in the next chapter.

One of the interesting general aspects of the reporting of fixed assets in the Convention Blank is that the amount reported is a net figure after deducting any encumbrances on the property. Since most life insurance companies use cost less accumulated depreciation for the value of the property, the net result is that the figure shown in the Convention Blank balance sheet is the net effective investment of funds obtained from policyholders and stockholders in the asset. Encumbrances are relatively rare, but the usual commercial accounting preference would be to show the encumbrance as a liability and the asset at depreciated cost. This would provide a more complete picture of the funds which have been made available to the

---

[1]Beardsley, p. III-13. The official instructions for the Convention Blank simply refer to state law by noting in the instructions for Exhibit 13 that furniture and equipment should "be carried at zero value in Column (4), Net Admitted Assets, except for electronic data processing equipment which may be carried at such admitted asset value as permitted by law, ruling, or regulation...."

management of the company and what has been done with them, but the net effective amount of policyholder and stockholder funds invested in the property which is shown in the regulatory system is also pertinent information.

Many of the adjustments pertaining to fixed assets are peculiar to one or two companies, so are discussed when the company is analyzed. However, a few items are common to several companies, so are given standard adjustment numbers and are discussed in the following pages.

Adjustment 50. Record furniture and equipment, and

Adjustment 51. Record depreciation of furniture and equipment

All fixed assets other than real estate are included under the furniture and equipment caption in the Convention Blank by most life insurance companies, but a few segregate such items as automobiles and airplanes. Except for the electronic data processing equipment mentioned above, the assets classified as furniture and equipment do not qualify as admitted assets for regulatory purposes. Some life insurance companies charge the entire cost of these items to general expense when purchased. Other firms carry the cost less depreciation as an asset in the ledger and eliminate it as a non-admitted asset in Exhibit 13 of the Convention Blank.

Adjustments 50 and 51 are used only when the cost of furniture and equipment is charged directly to expense. Adjustment 50 simply transfers the cost of the items purchased from expense to an asset account. Adjustment 51 records depreciation on the asset recorded by Adjustment 50. Since there is no way of knowing how long each item is used by the company from the data in the Convention Blank, an arbitrary ten-year period is used for

depreciation. When the cost has been fully depreciated, the asset account is written off against the accumulated depreciation account. In practice, it would be better to retain both accounts until the asset is actually retired from use.[1]

Adjustment 52. Reverse entry for change in net book value of furniture and equipment

Prior to 1949 life insurance companies were required to charge all purchases of furniture and equipment to expense immediately. Starting in 1949 the Convention Blank was changed so as to permit capitalization and depreciation of these items. The depreciation is then included in general expenses.[2] Up to this point, the procedure appears the same as that used by commercial firms. However, a life insurance company is required to eliminate the book value (cost less depreciation) of furniture and equipment as a non-admitted asset. The net effect is the same as though the asset were written off. This is easiest to visualize by examining an example. Suppose that equipment costing $1,000 was purchased on January 1, and that it is depreciated at the rate of 10 per cent per annum. In the year of acquisition, $100 will be charged to depreciation expense and $900

---

[1]The mechanics of making Adjustments 50 and 51 are simple because the cost of furniture and equipment purchases which are charged to expense are listed on line 5.5 of Exhibit 5--General Expenses. This amount is entered on a worksheet and spread over the ten-year depreciation period, using a half-year's depreciation in the year of acquisition. A sample worksheet is included as Appendix II.

The cost of furniture and equipment acquired during the ten-year period prior to the start of the test period had to be obtained by correspondence with foreign companies because the Nebraska Insurance Department, in common with most departments, retains the Convention Blanks of foreign companies for only five years.

[2]On the same line 5.5 of Exhibit 5 as is used when the entire cost is charged to expense at the date of acquisition.

will be charged directly to Surplus under the caption "Net loss from non-admitted and related items." The entire $1,000 is therefore written off in that year. In subsequent years, $100 will be charged to depreciation but is offset by an income item of $100 entered direct to Surplus under the "Net gain from non-admitted and related items" caption. The Convention Blank Surplus is therefore not affected by the depreciation entries, but the net operating profit shown in the Summary of Operations on Page 4 of the blank conforms with generally accepted accounting principles so far as this furniture and equipment is concerned.

For the companies which have capitalized furniture and equipment items, the write-off of the net book value is eliminated with Adjustment 52, thus reinstating the asset to the balance sheet and eliminating the off-setting of depreciation by an increase in Surplus. The depreciation rates used by the life insurance companies are accepted.

CHAPTER IV

THE COMPANIES ANALYZED IN DETAIL

In order to fully understand the Convention Blank, it is helpful, if not absolutely necessary, to work with it. One of the first steps in the research for this dissertation was to plunge directly into the Convention Blanks of the Nebraska domestic life insurance companies which are on file in the Department of Insurance of the State of Nebraska. The selection of the trial company was completely impartial. First, the companies with extraordinarily simple statements, the mutual companies, and those concerns which were doing little or no current business were eliminated. One of the remaining firms had been formed seventeen years previously, so it was chosen in the belief that it would provide a gradual build-up of complexity and that it would also bring out the details of the major change in the Convention Blank in 1951. It turned out that this firm had more complications than any firm studied, so the indoctrination was a thorough one.

A conventional financial statement worksheet was started for the first year of the company's existence. The principal statements in the Convention Blank were entered on the worksheet in trial balance form. Each account was then analyzed to determine how closely the treatment of that item corresponded with the generally accepted accounting principles which are acknowledged as applicable to commercial and manufacturing companies. This required extensive concurrent use of library materials on insurance

and insurance accounting and many hours of tracing items through the Convention Blank. The need for, and the possibility of making, the groups of adjustments discussed in the preceding chapter was gradually worked out, and the worksheet was revised through trial and error until a standard style was developed which could be used for all companies.

In order to show the exact procedure finally adopted for the detailed analyses, the worksheet for one year for Firm F is included as Appendix II. Note that every adjusted balance sheet figure can be checked against some item in the Convention Blank (since the revised form was adopted in 1951) and that the entire worksheet embodies the complete integration of real and nominal accounts which is inherent in double entry accounting.

The format of the revised financial statements which are prepared from the worksheets was similarly worked out on an experimental basis. These statements were outlined in the preceding chapter, but it may be well to re-emphasize that the format is one which seems to the writer, as a certified public accountant with several years of both practice and teaching experience, to meet the minimum requirements for certification as being in conformance with generally accepted accounting principles and hopefully also meeting the technical requirement that it "shall correspond with or include the corresponding items from its verified statement made to the Department of Insurance."[1] Whether or not the latter requirement is fulfilled is a matter of law and no representation is made herein that the proposed statements would or would not be acceptable under present statutes. If they do not, the statutes could be amended. It must be emphasized, however, that all of the information in the statements is taken from the

---

[1]Section 44-324, Revised Statutes of Nebraska.

Convention Blank, but that some of it is from the detailed schedules deep in the blank rather than in the summary statements on pages 2, 3 and 4.

There is no logical order in which the companies should be discussed. With the exception of the trial company, the research was done in somewhat the order of size. This is probably as good an arrangement to follow as any because it will thereby permit the simpler statements to be discussed first. It must be kept in mind, however, that the companies discussed first are specialty companies to some extent and are therefore not typical firms. Although the data in the Convention Blank are public information in the sense that anyone can go to the Insurance Department and examine the Convention Blanks on file there is nothing to be gained by stating the names of the firms, so they are given alphabetical designations.

The discussion regarding each firm calls attention to features of the financial statements for that firm which have not been previously discussed, and to adjustments which are peculiar to that company. Many of these adjustments have intriguing aspects and reveal more of the underlying philosophy of life insurance accounting and reporting than do the more routine adjustments discussed in the preceding chapter.

COMPANY A

History

Firm A was incorporated in 1954 as a subsidiary of a consumer finance company. It is an unusual company in several respects. It writes only credit life, disability, accident and sickness insurance. It shares office space with its parent company, and expenses are allocated between them. If these peculiarities are kept in mind, it is a good firm with which to start this analysis because its structure is simple.

Adjustments Peculiar to Company A

The most unusual aspect of the adjustments for Company A is that the deferred first-year life insurance commissions are small. The reason is that all of the premiums are single premium term credit insurance. The method of deferment is similar to that for accident and health insurance rather than the five-year amortization method used for other firms.

The only other adjustment made for Firm A involves a correction of the method of handling the accrual of Federal income taxes in 1957. No effort was made to seek out corrections of this kind, but if discovered the appropriate correction is made to the revised statements.

As was pointed out in Chapter I, one of the limitations of this study is that there is no way of making even approximate adjustments for Federal income taxes on income which has been earned but which is not yet taxed under the special formula applicable to life insurance companies. In the instance of Firm A, however, income taxes have apparently been accrued on a sound basis by the company itself. The company was examined as of December 31, 1962, by the Nebraska Insurance Department, but the examination report simply observes that the company figures are accepted. However, the liability reported on December 31, 1962, is $1,149,226.90 whereas the expense for the year 1962 was only $773,000.00.

The Financial Statements

The financial statements for Life Insurance Company A are the simplest of any of the firms analyzed in detail. This permits the discussion to move step by step from the general outline in the last chapter, to the uncomplicated statements for this company, then on to more and more complicated situations in the discussion of the other companies. Most of the

factors discussed in the following paragraphs are, therefore, essential to the understanding of the statements of all of the companies.

Comparative Earnings Statement - Exhibit I

The comparative earnings statement, as revised to conform with generally accepted accounting principles, is an attempt to summarize the essential elements of a fair measurement of the earnings of the firm. It embodies both the earnings of the current year and the accumulated earnings from prior years. The statement is, therefore, a combined statement of income and retained earnings.

The current operating concept.--Although the term is not used, the Convention Blank calls for the current operating concept[1] in an extreme form. Several items which commercial firms using the current operating concept would always include in operating revenue and expense are entered direct to Surplus in the Convention Blank.[2]

The combined income and retained earnings statement provides a more meaningful presentation for life insurance companies than division into two statements. An annual accounting period is far too short a portion of the operating cycle of most life insurance companies to provide a satisfactory measure of the "normal operations" emphasized in the current operating concept.

The underlined captions in Exhibit I can be viewed as measurements of flows which result in earnings. The final measurement is the net

---

[1]This concept is discussed and contrasted with the "clean surplus" concept in all standard accounting theory textbooks.

[2]See page 4 of the Convention Blank form in Appendix III. Many companies are inclined to report all transactions which are not strictly routine in the blank spaces in the analysis of the Surplus account.

addition to or reduction of retained earnings for the period. The intermediary captions allow the reader to choose the point of measurement which is most useful for his immediate purpose--net insurance income, net income before income tax, net income, or the final increment in unrestricted retained earnings--without letting him ignore how the figure he chooses fits into the entire picture.

Investment income.--One of the major changes from the Convention Blank presentation is that of showing the gross investment earnings as revenue. The expenses are deducted as one of the items under the "Acquisition, Investment and Administrative Expense" caption. This procedure is more in keeping with the concept of gross revenue, a figure which may at times be significant.

The taxes which are included in investment expenses in the Convention Blank are reclassified back into the Taxes, Licenses and Fees item in this statement and are not included in the General Investment Expense caption. The mechanics of making this reclassification are illustrated in the sample worksheet in Appendix II.

Transfers to appropriated surplus.--The only appropriation of surplus by Life Insurance Company A is the Mandatory Securities Valuation Reserve. The reasons for showing this account as an appropriation of surplus are outlined in the discussion of the balance sheet in the next few pages.

Reconciliation - Exhibit II

This statement serves two important purposes. First, it proves the accuracy of the revised earnings statement by explaining the differences between the Summary of Operations and Surplus Account in the Convention Blank and the Revised Earnings Statement in this report. Second, it reflects the significance of the adjustments which are made.

Mechanics.--The first line in the reconciliation is captioned "Gross Income." This figure does not appear in the Convention Blank, but all of the amounts necessary to compute it do. None of the figures which are used to compute gross income are affected by the adjustments made in this report, so gross income is the logical starting point for a reconciliation.

The Acquisition, Investment and Administrative Expense items are not always the same in the Convention Blank and in the revised earnings statement. They are, therefore, tabulated in the reconciliation so that an item by item comparison with the Revised Earnings Statement may be made if desired.

The "Net gain (loss) from operations per the Convention Blank" agrees with the final "Net gain from operations" shown on line 33 of the Summary of Operations section of Page 4 of the Convention Blank (see Appendix III).

Items entered direct to Surplus in Convention Blank.--Those items which are entered direct to Surplus in the Convention Blank are divided into two groups in this study. Such items as dividends and transfers to appropriated or restricted Surplus are shown under the "Dispositions of Income" caption near the bottom of the Revised Earnings Statement. The remaining items are taken into income. The latter then also become reconciling items in Exhibit II. Some items must be shown as one of the "Items Entered Direct to Surplus" even though they are cancelled-out in the Adjustments Section. This is necessary in order to compute the "Net per Convention Blank before Items Classed as Dispositions of Income," which is in reality the net income that would be reported in the Convention Blank if that form used the all-inclusive type of earnings statement.

The $5,945.00 "Change in Value of Assets Owned at End of Year" illustrates these points clearly. This $5,945.00 is the "loss" in the market value of common stocks owned at the end of the year.

Balance Sheet, December 31, 1962 -
Exhibit III

The balance sheet used in this study contains more innovations than the other statements, so the gradual development from the relatively simple statement for Company A to the more complicated statements of the other companies should be helpful.

An effort is made throughout the financial statements to reflect basic concepts in a manner which will be understood by the reader who is not a technical expert in insurance but is familiar with commercial financial reports. Special care has to be taken in the balance sheet. Standard terminology which is familiar to the readers of financial statements is followed wherever possible. However, when a specialized technical insurance account is involved, descriptive captions are used so long as they do not do violence to important technical relationships.

Format.--The basic structure of the balance sheet used in this study was outlined in the preceding chapter. This balance sheet is designed to meet a number of essential criteria including: (1) It must adhere to the statutory requirement that it shall "correspond with or include the corresponding items from" the Convention Blank; (2) It must list all of the funds which have been made available to the firm, including earnings; and (3) It must show all of the assets these funds are invested in, thus accounting for all that has been made available to the firm.

Important relationships.--Attention to certain key relationships should help specify the manner in which the requirements stated in the

preceding paragraph are met. First, the liabilities and legal capital are identical with the Convention Blank down to the caption "Total based on National Association of Insurance Commissioners Valuation of Admitted Assets." Note particularly that the statutory legal "policyholder surplus" is clearly set forth at the exact amount computed in the Convention Blank.

Assets are stated at both the effective amount invested in them (amortized cost) and at the National Association of Insurance Commissioners valuation. The N.A.I.C. valuation is a memorandum entry. The difference between the two valuations is used on the credit side to convert the Convention Blank liabilities and surplus to the investment which has been made available to management of the firm. The effective amount invested in admitted assets is thus proved equal to the funds made available for this purpose.

After reaching this mid-point balance, non-admitted assets are added to admitted assets and the source of funds used to acquire them are added to the legal investment so that a final balance is reached which includes everything management needs to account for. The balance sheet now includes the solvency concepts of the Convention Blank and also the going concern concept of commercial accounting. No other industry can so easily have both of these important concepts in one statement.

One of the most important relationships in this balance sheet is that of the statutory insurance reserves and the revenue-producing assets. The insurance regulatory system has conventionally listed these items first in the balance sheet, and there is no apparent reason to change. These items are peculiar to the life insurance industry and are the most important items from the regulatory viewpoint in most cases. The remainder of the balance sheet is similar to the balance sheet of a commercial or manufacturing

business. The only real difference is that the assets are divided into two groups--those which qualify as legal investments of insurance reserves and those which do not, i.e. admitted and non-admitted assets.

Life Insurance Company A is unusual because it has no ordinary life insurance or endowment insurance reserves. As a consequence the revenue-producing assets are considerably in excess of the statutory insurance reserves. This permits the current assets to be less than current liabilities.

A final comment concerning important relationships is pertinent at this point. It is often contended that the classification of current and fixed assets is not significant for a life insurance company. When one realizes that the revenue-producing assets are primarily the fund covering the statutory reserves (granting that the reserves can also be invested in certain operating assets) and that the remainder of the balance sheet is essentially the same as in any other enterprise, the amount invested in working capital does have significance. So does the amount invested in buildings and other fixed assets.

Descriptive captions.--There is always danger in adopting the descriptive captions mentioned in the introduction to this section. Technicians who are familiar with standard terminology are often bewildered when different, and often imprecise, captions are substituted for terms they have come to use every day. One of the important aspects of published reports should be strict adherence to the goal of having the same term mean the same thing regardless of the industry or company involved.

An effort has therefore been made to use standard terminology whenever possible. The only departures used are those which are made deliberately for emphasis or when insurance industry terminology is so different

from commercial and manufacturing terminology as to be grossly misleading to the reader who is familiar with the reports of commercial firms. The principal departures are discussed in the following paragraphs.

The words "invested in" are inserted in each of the underlined sub-totals and totals on the asset side. This is done to emphasize that the balance sheet assets are a historical record of the effective amount invested in the assets rather than the market value which is theoretically used in much of the regulatory system. These words should serve as a constant reminder to those familiar with insurance reports that this balance sheet is based on cost.[1]

The caption "Assets Admitted As Legal Investments of Insurance Reserves" should help the non-insurance oriented reader understand what admitted assets are, or at least prompt him to ask pertinent questions in an effort to understand the concept. For internal reports, the caption "Admitted Assets" would be sufficient. Similarly, the bottom portion could be labeled "Non-admitted Assets" in internal reports.

The term "Revenue-producing Assets" is not used elsewhere in the literature. It may well be that someone within the industry will find a better term should the industry decide to experiment with this type of balance sheet.

The most troublesome captions are on the right side of the balance sheet. Every effort is made to distinguish the double entry accounting type of balance sheet from the formula type used in the Convention Blank. The standard captions of "Net Worth" and "Equity" both seem to denote value

---

[1]This wording might serve a similar purpose in commercial and industrial accounting by focusing attention on the reason for use of cost.

to some extent, so are avoided. The caption "Investment" is used, but not without some misgivings. The term has the advantage of emphasizing the correlation of the "investment by" various sources as the funds made available to the firm and the assets which those funds are "invested in". The danger is that the word "investment" may seem to belong on the asset side. This caption is one which should concern accountants in all industries, and if discussion can be stimulated someone will undoubtedly find the one best caption. The important criterion is that it not carry the connotation of value. This will be especially important if commercial and manufacturing firms ever decide to seriously experiment with supplemental statements reflecting values. It is important now in industries such as life insurance where the primary regulatory statements stem from value concepts.

The importance of this terminology can be emphasized by pointing out that the legal capital based on the Convention Blank shows <u>equity</u> because it is based on the <u>value</u> of admitted assets, but the so-called "stockholders' equity" section of the commercial balance sheet does not. The latter shows the amount of the investment in the firm ordinarily by contribution for stock or through retention of profits.

One remaining caption requires comment. The typical non-insurance reader of financial statements has difficulty understanding policy reserves. One reason for this is that the word "reserve" is used in many ways in finance and accounting in spite of progress in limiting its use in financial statements. The other reason is that he does not fully understand insurance and the net level premium concept. It is hoped that the caption "Portion of Premiums and Investment Income Held As Reserves" might contribute a little to such understanding, even though there must be technical reservations.

The standard terminology of the insurance industry is used in the underlined caption for the subtotal, just as is done for admitted and non-admitted assets.

Mandatory Securities Valuation Reserve.--This reserve is analyzed in detail in the recent book by Professor Harold G. Fraine[1] so a few general observations are sufficient here. The purpose of the reserve, first required in 1951, was to minimize the effect of fluctuations in the asset values of bonds and stocks from year to year on legal surplus. A specified minimum reserve must be maintained, but there is a rather wide latitude of choice in the size of this reserve so long as it remains between the minimum and maximum permitted by the regulations.[2] The rules are extremely complex[3] but the essential feature is the attempt to build a maximum reserve which will equal 1 per cent of the admitted value of amortizable bonds and 20 per cent of the statement value of non-amortizable bonds and 30 per cent of stocks. Generally, 1/20 of 1 per cent of amortizable bonds and 1 per cent of non-amortizable bonds and stocks is credited to the reserve each year along with all capital gains, both realized and unrealized, after deducting income taxes on these gains. The reserve is reduced by capital losses, both realized and unrealized. However, these amounts are modified by the maximum reserve, the minimum reserve, and numerous other technical factors.

---

[1]Valuation of Securities Holdings of Life Insurance Companies (Homewood, Illinois: Richard D. Irwin, Inc., 1962).

[2]Charles M. Beardsley, Life Company Annual Statement Handbook (Winston-Salem, North Carolina: The author, 1962 - looseleaf).

[3]Fraine characterizes them as follows: "The rules for the valuation reserve occupy only two printed pages of the Committee publication, but appear--at least at first glance--so complicated as to defy ready understanding." p. 17.

The regulatory literature treats this reserve as an "above the line" item--that is, as a liability. It is given a specific spot under Item 25 on Page 3 of the Blank under the caption of "Miscellaneous Liabilities."[1] It is not, therefore, permissible to list it on one of the blank spaces under Item 27--"Special Surplus Funds."

Just listing an account among the liabilities on the Convention Blank does not make it a liability, however. The term, "liability" has been defined in various ways, but all of the definitions used in accounting carry some reference, express or implied, to an obligation arising in the past which must be satisfied in the future, either by payment or rendering of services.[2] The fundamental structure of double entry accounting requires that all sources of funds be listed in the balance sheet, but that those which have to be repaid in some manner be classed as liabilities. There seems to be no obligation to anyone in connection with the Mandatory Securities Valuation Reserve, so it is not a liability in the accounting sense. Only when the Convention Blank balance sheet is viewed as a formula for the computation of legal surplus does the Mandatory Securities Valuation Reserve qualify as a liability--because it is a deduction from assets to arrive at Surplus.

The title of the reserve indicates that it should be deducted from an asset in the same way the "Reserve" for Bad Debts and the "Reserve" for Depreciation are handled in commercial accounting. This treatment has been

---

[1]See the sample pages of the Blank in Appendix III.

[2]The American Accounting Association has defined liabilities as "Claims of creditors against the enterprise, arising out of past activities, that are to be satisfied by the disbursement or utilization of corporate resources." Accounting Concepts and Standards Underlying Corporate Financial Statements, 1948 Revision, reprinted in the 1957 combined Pamphlet.

assumed by some. For example, a footnote in one of the brochures written by a prominent actuary for the Chartered Life Underwriter (CLU) course states that "accepted accounting practice would treat the Mandatory Securities Valuation Reserve not as a liability but as a negative asset to be deducted from securities...."[1] However, in the concerns analyzed in this study there seems to be little or no relationship to expected losses in the way the reserve is built up. The largest credits to the reserve for many of these companies come from capital gains. For many concerns these capital gains are unrealized--that is, they are simply the increase in the market value of common stocks held. As a result, the legal surplus account is increased by the unrealized increment in the value of the stock, but is decreased by nearly this same amount through the transfer to the Mandatory Securities Valuation Reserve. For these companies, the Mandatory Securities Valuation Reserve is virtually an "Unrealized Increment From Appraisal," which account is always reported as a special item in the Investment by Stockholders, or "Stockholders' Equity," section of the balance sheet of commercial and industrial concerns. The extent to which the Mandatory Securities Valuation Reserve partakes of the nature of an "Unrealized Increment From Appraisal" type of account depends upon the investment securities held, the nature of the market fluctuations, whether or not the Reserve has reached the maximum, and other factors. In any event, this Mandatory Securities Valuation Reserve is not a valuation reserve in the same sense as are the "Reserves" for depreciation and bad debts, and should not be deducted from securities.

---

[1]B. Franklin Blair, Interpreting Life Insurance Annual Reports (Bryn Mawr, Pennsylvania: The American College of Life Underwriters, 1960), page 19, footnote 25.

Since the purpose of the Mandatory Securities Valuation Reserve is to minimize the effect of changes in the market value of securities on legal surplus, it is really an appropriation account. This was well brought out in the informal discussions at one of the meetings of the Society of Actuaries soon after the Reserve was instigated when Mr. R. D. Murphy stated that he very strongly doubted that the securities valuation reserve would ever be treated as a liability if a company's solvency were in question; its true nature as part of surplus would then have to be recognized.[1]

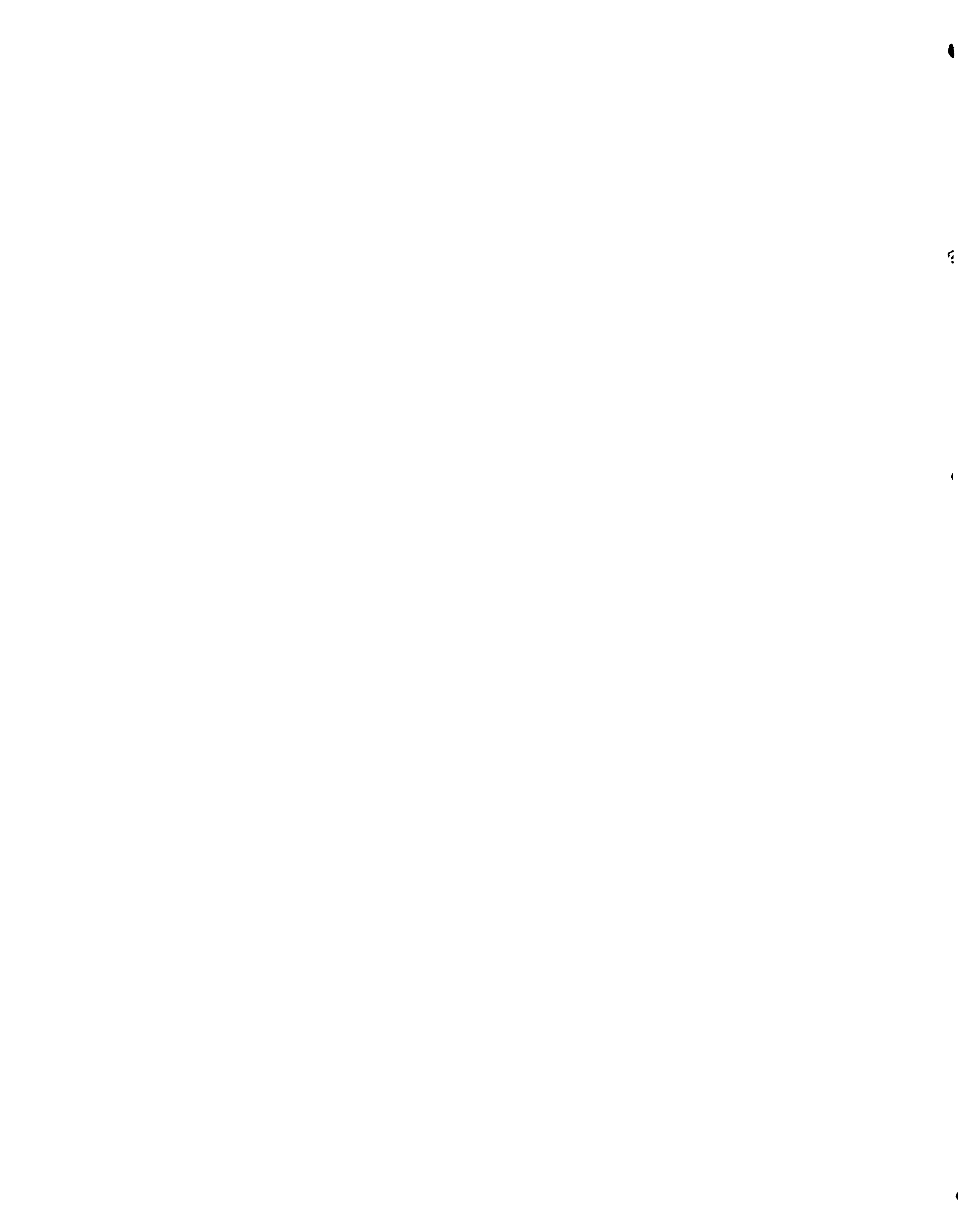
---

[1] Transactions, Society of Actuaries, Volume IV, Meeting Number 8 (1952) page 143.

Life Insurance Company A
Comparative Earnings Statement
As Revised to Conform With "Generally Accepted Accounting Principles"

Exhibit I

	1954	1955	1956	1957	1958	1959	1960	1961	1962
Revenue:									
Premiums--all on credit insurance:									
Life	$ 221,074.83	$ 980,332.24	$ 732,414.95	$ 877,791.75	$ 949,045.26	$1,082,057.32	$ 814,425.80	$1,688,051.51	$1,639,444.61
Accident and health	86,783.47	425,690.62	350,316.93	456,291.41	475,527.50	579,577.90	662,430.37	698,700.04	631,279.14
Interest, rent and dividends earned on investments	750.00	12,656.23	25,239.70	35,774.14	57,731.39	80,535.41	99,734.66	100,449.69	121,902.27
Total	$ 308,608.30	$1,418,679.09	$1,107,971.58	$1,369,857.30	$1,482,304.15	$1,742,170.63	$1,576,590.83	$2,487,201.24	$2,392,626.02
Add (deduct) change in legal reserve	(117,160.93)	(327,761.00)	9,450.12	(108,970.62)	(13,411.97)	(59,682.66)	76,593.79	(23,105.23)	30,895.19
Gross revenue	$ 191,447.37	$1,090,918.09	$1,117,421.70	$1,260,886.68	$1,468,892.18	$1,682,487.97	$1,653,184.62	$2,464,096.01	$2,423,521.21
Benefits and Payments on Contracts	76,228.08	349,685.94	337,314.57	475,310.37	482,739.56	525,980.26	424,786.72	700,956.43	550,659.02
Gross income	$ 115,219.29	$ 741,232.15	$ 780,107.13	$ 785,576.31	$ 986,152.62	$1,156,507.71	$1,228,397.90	$1,763,139.58	$1,872,862.19
Acquisition, Investment and Administrative Expense:									
Commissions	$ 15,939.09	$ 73,778.38	$ 71,945.06	$ 68,585.66	$ 79,816.62	$ 100,562.85	$ 81,395.55	$ 194,736.72	$ 184,193.57
General insurance expense	17,725.44	110,570.70	118,279.99	111,611.60	111,738.49	126,794.56	112,358.14	174,720.73	198,808.84
General investment expense	25.00	1,410.00	1,410.00	1,410.00	1,536.75	1,465.57	1,570.33	1,636.18	1,592.79
Taxes, licenses and fees (other than income tax)	821.34	4,090.49	3,217.24	4,051.34	5,758.01	5,766.36	4,522.68	14,844.91	3,854.31
Total	$ 34,510.87	$ 189,849.57	$ 194,852.29	$ 185,658.60	$ 198,849.87	$ 234,589.34	$ 199,846.70	$ 385,938.54	$ 388,449.51
Net insurance income (loss)	$ 80,708.42	$ 551,382.58	$ 585,254.84	$ 599,917.71	$ 787,302.75	$ 921,918.37	$1,028,551.20	$1,377,201.04	$1,484,412.68
Capital Gains and Losses	-	-	-	-	-	-	5,463.44	29,632.41	90.00
Net income (loss) before income tax	$ 80,708.42	$ 551,382.58	$ 585,254.84	$ 599,917.71	$ 787,302.75	$ 921,918.37	$1,034,014.64	$1,406,833.45	$1,484,502.68
Income Taxes	166.93	2,059.02	6,816.05	8,424.91	103,277.27	399,722.73	443,000.00	730,000.00	773,000.00
Net income (loss)	$ 80,541.49	$ 549,323.56	$ 578,438.79	$ 591,492.80	$ 684,025.48	$ 522,195.64	$ 591,014.64	$ 676,833.45	$ 711,502.68
Dispositions of Income:									
Transfers to appropriated surplus	$ 100.00	$ 200.00	$ 770.92	$ 556.13	$ 833.61	$ 809.34	$ 850.00	$ 894.00	$ 4,301.00
Dividends to stockholders	-	200,000.00	300,000.00	300,000.00	350,000.00	600,000.00	350,000.00	100,000.00	
Total dispositions of income	$ 100.00	$ 200,200.00	$ 300,770.92	$ 300,556.13	$ 350,833.61	$ 600,809.34	$ 350,850.00	$ 100,894.00	$ 4,301.00
Net addition to (reduction of) unrestricted retained earnings	$ 80,441.49	$ 349,123.56	$ 277,667.87	$ 290,936.67	$ 333,191.87	$ (78,613.70)	$ 240,164.64	$ 575,939.45	$ 707,201.68
Beginning Unrestricted Retained Earnings	-	80,441.49	429,565.05	707,232.92	998,169.59	1,331,361.46	1,252,747.76	1,492,912.40	2,068,851.85
Ending Unrestricted Retained Earnings	$ 80,441.49	$ 429,565.05	$ 707,232.92	$ 998,169.59	$1,331,361.46	$1,252,747.76	$1,492,912.40	$2,068,851.85	$2,776,053.53



Life Insurance Company A
Reconciliation of Revised Earnings Statements
With Summaries of Operations and Surplus Account in the Convention Blanks

Exhibit II

	1954	1955	1956	1957	1958	1959	1960	1961	1962
Convention Blank Figures:									
Gross income	$115,219.29	$741,232.15	$780,107.13	$785,576.31	$986,152.62	$1,156,507.71	$1,228,397.90	$1,763,139.58	$1,872,862.19
Acquisition, investment and administrative expense:									
Commissions	$ 23,574.44	$ 96,736.31	$ 66,168.24	$ 67,824.36	$ 86,876.98	$ 105,160.68	$ 73,002.99	$ 217,499.46	$ 172,675.28
General insurance expense	17,725.44	110,570.70	118,279.99	111,611.60	111,738.49	126,794.56	112,358.14	174,720.73	198,808.84
General investment expense	25.00	1,410.00	1,410.00	1,410.00	1,536.75	1,465.57	1,570.33	1,636.18	1,592.79
Taxes, licenses and fees (including income tax)	988.27	6,149.51	10,033.29	10,520.76	110,990.77	405,489.09	447,522.68	744,844.91	776,854.31
Total expenses per Convention Blank	$ 42,313.15	$214,866.52	$195,891.52	$191,366.72	$311,142.99	$ 638,909.90	$ 634,454.14	$1,138,701.28	$1,149,931.22
Net gain (loss) from operations per the Convention Blank	$ 72,906.14	$526,365.63	$584,215.61	$594,209.59	$675,009.63	$ 517,597.81	$ 593,943.76	$ 624,438.30	$ 722,930.97
Items entered direct to the Surplus account:									
Capital gains and losses on assets sold	$ -	$ -	$ -	$ -	$ -	$ -	$ 5,463.44	$ 29,632.41	$ 90.00
Change in value of assets owned at end of year	-	-	-	-	-	-	-	-	(5,945.00)
	$ -	$ -	$ -	$ -	$ -	$ -	$ 5,463.44	$ 29,632.41	$ (5,855.00)
Net per Convention Blank before items classed as "Dispositions of Income"	$ 72,906.14	$526,365.63	$584,215.61	$594,209.59	$675,009.63	$ 517,597.81	$ 599,407.20	$ 654,070.71	$ 717,075.97
Adjustments to Bring Into Conformance With Generally Accepted Accounting Principles:									
Reverse adjustment of stocks owned to market value, thus returning them to cost	$ -	$ -	$ -	$	$ -	$ -	$ -	$ -	$ 5,945.00
Commissions deferred to period in which the related premiums are taken into revenue	7,635.35	22,957.93	(5,776.82)	(761.30)	7,060.36	4,597.83	(8,392.56)	22,762.74	(11,518.29)
Accrued income taxes	-	-	-	(1,955.49)	1,955.49	-	-	-	-
Total adjustments	$ 7,635.35	$ 22,957.93	$ (5,776.82)	$ (2,716.79)	$ 9,015.85	$ 4,597.83	$ (8,392.56)	$ 22,762.74	$ (5,573.29)
Net income (loss) per revised earnings statement	$ 80,541.49	$549,323.56	$578,438.79	$591,492.80	$684,025.48	$ 522,195.64	$ 591,014.64	$ 676,833.45	$ 711,502.68
Difference Between Net Gain From Operations per the Convention Blank and Net Income per the Revised Earnings Statement	$ 7,635.35	$ 22,957.93	$ (5,776.82)	$ (2,716.79)	$ 9,015.85	$ 4,597.83	$ (2,929.12)	$ 52,395.15	$ (11,428.29)

Life Insurance Company A
Balance Sheet Extended to Conform With "Generally Accepted Accounting Principles"
December 31, 1962

Exhibit III

ASSETS

	N.A.I.C. Value		Amortized Cost
Assets Admitted As Legal Investments of Insurance Reserves:			
Revenue-producing assets:			
Bonds	$3,798,777.53		$3,798,777.53
Stocks	10,867.50		16,812.50
Mortgage loans on real estate	7,427.40		7,427.40
Total valuation prescribed by National Association of Insurance Commissioners	$3,817,072.43		
Total invested in revenue-producing assets . . .			$3,823,017.43
Operating assets--at cost which is also the valuation prescribed by the National Association of Insurance Commissioners:			
Current assets:			
Cash and bank deposits		$573,384.52	
Insurance premiums receivable (all credit insurance):			
Life		157,956.91	
Accident and health		55,015.88	
Accrued interest receivable		43,975.95	830,333.26
Total invested in admitted assets			$4,653,350.69
Operating Assets Which Do Not Qualify As Legal Investments of Statutory Insurance Reserves:			
Commissions deferred to future periods:			
On credit life insurance		$ 32,279.20	
On accident and health insurance		6,286.04	
Total invested in non-admitted assets			38,565.24
Total invested in all assets			$4,691,915.93

LIABILITIES and INVESTMENT

Portion of Premiums and Investment Income Held As Reserves:			
On credit life policies and contracts		$ 446,169.19	
On accident and health policies		86,984.12	
Total statutory insurance reserves			$ 533,153.31
Current Liabilities:			
Policy and contract claims		$ 9,340.23	
Amounts withheld or held as trustee		3,493.74	
Accrued general expenses payable		7,922.74	
Accrued taxes--other than income tax		3,410.48	
Provision for Federal income taxes		1,149,226.90	
Total liabilities			1,173,394.09
Legal Capital:			
Capital stock--1,500 shares at $100 par		$ 150,000.00	
Surplus of N.A.I.C. valuation of admitted assets over liabilities, capital stock and appropriations		2,781,543.29	
Total legal "policyholder surplus"		$2,931,543.29	
Surplus appropriated for special purposes--mandatory securities valuation reserve		9,315.00	
Total based on National Association of Insurance Commissioners valuation of admitted assets		$2,940,858.29	
Add unrealized loss in N.A.I.C. valuation:			
Amortized cost of revenue-producing assets	$3,823,017.43		
N.A.I.C. valuation of revenue-producing assets	3,817,072.43	5,945.00	2,946,803.29
Total legal investment			$4,653,350.69
Investment by Stockholders:			
Amount paid-in for capital stock:			
Capital stock--1,500 shares at $100 par	$ 150,000.00		
Premium on capital stock	50,000.00	$ 200,000.00	
Retained earnings:			
Appropriated for special purposes--as above	$ 9,315.00		
Unrestricted--per earnings statement	2,776,053.53	2,785,368.53	
Total investment by stockholders		$2,985,368.53	
Deduct portion included in legal reserve capital above		2,946,803.29	
Net investment of funds provided by stockholders in non-admitted assets			38,565.24
Total liabilities and investment			$4,691,915.93

COMPANY B

History

Life Insurance Company B was incorporated in 1953 as a wholly owned subsidiary of a casualty insurance company. It shares home office facilities with this and other related companies. Certain types of insurance are written through a related company which has exclusive general agent rights. This general agent owns all of the office furniture and equipment and pays most of the office and administrative expenses in return for an overriding commission and a payment for handling claims. Company B originally wrote mostly credit insurance, but has expanded into ordinary life and accident and health insurance. The increasing importance of accident and health insurance is reflected in the first two lines of Exhibit I. Unfortunately, the principal exhibits in the Convention Blank do not segregate credit insurance, so it is not practical to attempt a segregation in this report.[1]

The Financial Statements

Since many types of expenses are paid by related companies, the financial statements of Life Insurance Company B are less complex than for other insurance companies. This relative simplicity, combined with the fact that the company now writes most kinds of life and accident and health insurance, permits the analysis of Company B to provide a good transition from the statements for the highly specialized operations of Company A to

---

[1]A special analysis of credit insurance is now appended to the Convention Blank, but it is not integrated into the main blank. This schedule was included for the first time in 1961 so was not available as a means of segregating credit insurance transactions for the entire period studied.

the statements reflecting the complex investment and underwriting activities of the other concerns analyzed.

The three principal financial statements were outlined in the discussion of Company A. Those comments are not repeated, but only those features not found in the statements for Company A are mentioned. The major change is that the details of the adjustments are listed in Schedule II(A) by groups and the Group totals are carried to Exhibit II. All of the adjustments which are made for Company B were discussed in the preceding chapter, with the exception of number 43. This adjustment is made in the same manner as number 41 so needs no elaboration.

The balance sheet is discussed before the earnings statement in this one instance. This is helpful in explaining one of the items in the earnings statement.

Balance Sheet - Exhibit III

There are only two significant innovations in the balance sheet for Company B which have not already been discussed in connection with the description of the balance sheet for Company A, but both are important in all of the balance sheets which follow.

Home office building.--Part of the home office is used by the Company and part is rented to related concerns. The effective investment (cost less accumulated depreciation) is divided between revenue-producing assets and operating assets in proportion to the rent the company charged itself[1] and the rent charged other companies in 1962.

---

[1]This rent is eliminated from investment income and from expense in the revised financial statements, as outlined in the discussion of the earnings statement.

The significance of reporting the amount invested in operating assets is well illustrated by the balance sheet of Company B. The revenue-producing assets are not only larger than the insurance reserves, a highly desirable relationship for almost any insurance company, but are larger than all of the liabilities. This means that the entire amount invested in the operating assets--both working capital and home office--has been provided by stockholders, either through original capital contribution or retention of earnings. This is a type of factual data which is important to stockholders and the public but is not readily ascertainable in the published reports based on the regulatory statements.

Reserves on life policies and contracts.--Life insurance policy reserves in the United States are computed on the policies in force on the assumption that premiums are paid annually in advance, and are based on "net premiums" after loading rather than on the gross premium charged the insured. Commercial accountants would assume that the reserve based on policies in force would be adjusted for quarterly and monthly premiums not yet due. The life insurance industry has taken a different approach. Both unpaid premiums on policies in the "grace period" and quarterly and monthly premiums not yet due are merged, the loading is deducted, and the balance is shown as an asset in the Convention Blank. This "asset" is not the amount receivable for past due premiums and is certainly not a deferred expenditure, even though the title of the account is "Life insurance premiums and annuity considerations deferred and uncollected." It is nothing more than a correction of reserves. Since the same legal surplus figure is obtained either way, the designers of the Convention Blank considered it simpler to add the account as an asset than to deduct it from

the

Bea

and

res

few

the

(Wi
16.

Li

the reserves. This process has been so simply and concisely stated by Beardsley that the best explanation is obtained by quoting him verbatim:

> Reserves for life insurance policies are normally calculated on the assumption that the insured pays premiums annually. This, of course, is an assumption which does not always agree with the actual facts, but it simplifies the calculations. Since many policies are paid periodically more often than once a year, a company's reserves usually overstate its true liabilities.
>
> The method used to correct this (or offset the overstatement) in a life insurance company's balance sheet is to increase the assets by the amount of the premiums needed to justify the assumption. Some of these premiums will still be in the course of collection (the "uncollected"), while others represent the amounts needed to complete the balance of payment up to the next policy anniversary (the "deferred").
>
> Reserves, moreover, are calculated by use of "net" premiums, i.e. premiums which assume only mortality and interest elements and do not consider the expenses of doing business. Therefore, an adjustment is made to the "gross" deferred and uncollected premiums to divest them of this loading.[1]

The extended balance sheets prepared in this study move the deferred and uncollected premiums account to its proper place as a deduction from reserves. This treatment is highly recommended by Wightman in one of his few criticisms of the Convention Blank. His remarks are so pointed that they, too, are quoted:

> There is probably no feature of the annual statement of a life insurance company which is quite as unintelligible to the typical layman as this particular asset item (Deferred and uncollected premiums). Inasmuch as it is introduced into the statement for purely correctional purposes and is in fact an adjustment of the amount reported as the policy reserve liability, it would appear not only theoretically proper but certainly less confusing to treat this item as a deduction from the policy reserve liability and to show only the net amount thus obtained in the liabilities statement. Under the prescribed method of showing this adjustment item in the annual statement, both the assets and the liabilities of a life company are clearly overstated.[2]

---

[1]Charles M. Beardsley, F.S.A., Life Company Annual Statement Handbook (Winston-Salem, North Carolina: The author, 1962), Section III, pp. 15 and 16.

[2]E. C. Wightman, Life Insurance Statements and Accounts (New York: Life Office Management Association, 1952) p. 580.

There is an additional complication reflected in the reserves section of the balance sheet for Company B. This is the account which carries the following caption in the liabilities section of the Convention Blank: " 'Cost of Collection' on Premiums and Annuity Considerations Deferred and Uncollected in Excess of Total Loading Thereon." This account is really a correction of the deferred and uncollected premiums account discussed in the preceding paragraphs, and is thus a correction of a correction.

This "Cost of Collection ...." account arises when the loading which is based on the statutory mortality and interest assumptions and is deducted from gross deferred and uncollected premiums to arrive at the net shown as an "asset" in the Convention Blank, is less than the loading which is based on actual mortality and interest earnings used in computing premiums.[1] When this situation exists, "an accounting loss may be suffered by the company when all of the respective premiums have either been paid or dropped from the assets because of default."[2] In order to bring such a possible loss into the current year, a "liability" is set up for the excess of the cost of collection over the loading on the deferred and uncollected premiums. This is done on an aggregate rather than a policy by policy basis, so many companies find that this account appears only during their early years. This is particularly true of mutual companies and those stock companies which issue participating policies.[3]

---

[1]Beardsley, Section III, page 148. A simple mathematical example is included on that page which clearly illustrates the principle.

[2]Wightman, p. 583.

[3]Wightman, pp. 584 and 585.

In effect, this "Cost of Collection ..." account is a deficiency reserve. It represents a portion of the premiums on other policies which is held out of revenue to cover the excess of renewal commissions and other collection costs which will be paid on the deferred and uncollected premiums in the future. It should, therefore, be reported in the Reserves section of the balance sheet. Again, the analysis by Wightman is so pointed that it warrants citation, not only because it supports this treatment, but because it explains one of the unusual items in the earnings statement:

> If . . . the deferred and uncollected premiums were (as herein suggested) deducted in the calculation of the policy reserve liability, the excess cost of collection might properly be treated as an additive to that liability. In the latter case, any change during the year in such excess cost would be taken into the Summary of Operations as an element in item 17 therein ("Increase in aggregate reserve for policies, etc.") In such case, also, the amount of the deferred and uncollected premiums would be entirely ignored in the computation of the amount to be reported on line 1.1 of the Summary of Operations. Under such a set-up, there would no longer be any necessity for the inclusion of line 25 in the Summary of Operations.[1]

Note that the method of presentation in Exhibit III shows the "Cost of Collection . . ." as a reduction of the net deferred and uncollected premiums. This emphasizes the relationship between the reserves and their source.

Earnings Statement - Exhibit I

Adjustment for expenses on increase in deferred and uncollected premiums.--This is the item which is referred to in the above quotation from Wightman as being entered on line 25 of the Summary of Operations. Its exact title in the Convention Blank is "Increase in loading on and

---

[1]Page 588. Line 25 of the Summary of Operations is discussed in the next section of this report.

cost of collection in excess of loading on deferred and uncollected premiums." One of the items entered in this account is the change during the year in the "Cost of collection . . ." account discussed above. This portion of the account is, as indicated in the preceding discussion, really an additional portion of receipts which is held out of revenue to cover expenses which will be incurred next year. The other item which is entered in this account is the loading in the change in the uncollected and deferred premiums during the year. This stems from the fact that premiums earned are computed on a gross basis, but reserves are computed on a net after loading basis.[1]

Rent for company's occupancy of its own buildings.--The official instructions for the Convention Blank require that the amount reported as real estate income "include adequate rent for the company's occupancy, in whole or in part, of its own buildings, and for space therein occupied by agencies." Presumably this is required in order to reflect a proper rate of return on investments, a ratio the regulatory authorities watch carefully.

Company B charges itself the same rate for the space occupied as it charges other tenants. However, some companies do not have such an objective basis for this charge.[2] Furthermore, there is no flow of funds into the firm corresponding to this "investment income." Consequently, statements which conform with generally accepted accounting principles should be prepared without such self-charge. The rent which the companies

---

[1]Wightman, p. 586.

[2]Some of the bases used are commented on later in the analysis of the companies involved. Several are quite interesting.

charge themselves is, therefore, reclassified out of investment income and out of expense[1] and, as noted previously, the cost of company-occupied real estate is shown as an operating asset rather than as a revenue-producing asset in the balance sheet.

No adjustment is made for the costs of operating the home office property, but the caption of the account in which they are reflected in Exhibit I is changed to "General investment and real estate expense." If these statements were to be adopted in practice, the companies would undoubtedly wish to segregate the real estate expense so that the remaining General Investment Expense would contain only those expenses which are properly matched against the revenue in the Investment Revenue account. The difference between the two accounts would then become the net investment income from the assets classed as "revenue-producing."

Income taxes.--The earnings statements in Exhibit I are seriously deficient in one regard. There is no way to estimate the income tax which will have to be paid on the income which has been accelerated into earlier years with the adjustments made in preparing that statement. Comparison of the income taxes paid by Company B with the operating income and capital gains shown in the Convention Blank (see Schedule II(A)) indicates clearly that there is no reasonable method of estimating even an average percentage which will be applicable. The only way this could be done would be by obtaining access to the income tax returns themselves. This is beyond the scope of this study, but is something which would have to be done before

---

[1]The mechanics of making this reclassification are illustrated in the sample worksheet in Appendix II.

statements of the type proposed in this study could truly be considered in accord with accepted principles.

In addition to the income tax on the difference between the Convention Blank income and the revised income, provision should be made for the income tax which will eventually have to be paid on the half of underwriting gains which is not taxed as long as they remain in the "policyholder surplus" account. Since the Convention Blank does not ask the insurance companies to report the balance in this account[1] there is no way to make a reasonably accurate adjustment for deferred income taxes on this untaxed income without going beyond the data in the Convention Blank. This aspect of deferred taxes, too, would have to be given recognition before statements of the type proposed in this study could truly be considered in accord with accepted principles.[2]

---

[1]This account is purely a memorandum account created solely for Federal income tax purposes and has no connection whatever with the books, records and annual statements of the company. For a pertinent criticism of the title assigned to this memorandum account in the Internal Revenue Code, see Edward G. Hearn, "Life Insurance Taxation Aspects of Phase III," _Proceedings 1960-61 of the Conference of Actuaries in Public Practice_, p. 74.

[2]The basic factors involved in income tax deferment and allocation are set forth in Chapter 10 of _Accounting Research and Terminology Bulletins_, Final Edition (New York: American Institute of Certified Public Accountants, 1961). All of the recent editions of standard textbooks on accounting theory contain discussion of the subject.

Life Insurance Company B
Comparative Earnings Statement
As Revised to Conform With "Generally Accepted Accounting Principles"

Exhibit I

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Revenue:										
Premiums and annuity considerations:										
Life	$399,276.22	$1,362,881.84	$1,978,246.38	$2,181,622.93	$2,091,456.83	$1,458,992.30	$1,789,469.25	$2,286,378.13	$1,974,431.01	$1,852,959.07
Accident and health	252,514.11	496,047.92	420,092.89	541,943.94	932,561.35	1,009,171.45	1,167,517.83	1,922,732.70	2,510,195.69	2,804,119.29
Consideration for supplementary contracts	-	-	-	-	-	-	-	-	5,605.00	-
Interest, rent and dividends on investments	14,816.35	38,324.78	121,302.95	171,809.79	205,642.39	256,668.43	291,394.84	354,848.00	298,208.90	265,411.99
Total	$666,606.68	$1,897,254.54	$2,519,642.22	$2,895,376.66	$3,229,660.57	$2,724,832.18	$3,248,381.92	$4,563,958.83	$4,788,440.60	$4,922,490.35
Deduct the portion:										
Set aside as policyholder reserves:										
Increase in legal reserves	$473,771.52	$ 699,577.26	$ 830,710.36	$ 381,047.47	$ 449,196.51	$ (271,359.46)	$ 381,064.67	$ 461,669.58	$ 643,289.33	$ 167,288.09
Adjustment for expenses on increase in deferred and uncollected premiums	-	3,400.00	5,302.59	(2,412.60)	(3,026.92)	4,297.20	29,170.53	27,904.45	9,515.00	33,226.83
Total portion not revenue this year	$473,771.52	$ 702,977.26	$ 836,012.95	$ 378,634.87	$ 446,169.59	$ (267,062.26)	$ 410,235.20	$ 489,574.03	$ 652,804.33	$ 200,514.92
Gross revenue	$192,835.16	$1,194,277.28	$1,683,629.27	$2,516,741.79	$2,783,490.98	$2,991,894.44	$2,838,146.72	$4,074,384.80	$4,135,636.27	$4,721,975.43
Benefits and Payments on Contracts	35,020.00	292,086.81	607,524.47	771,718.49	1,031,911.22	1,010,892.02	1,014,606.19	1,640,896.40	2,455,527.29	2,382,452.42
Gross income	$157,815.16	$ 902,190.47	$1,076,104.80	$1,745,023.30	$1,751,579.76	$1,981,002.42	$1,823,540.53	$2,433,488.40	$1,680,108.98	$2,339,523.01
Acquisition, Investment and Administrative Expense:										
Commissions	$ 34,711.20	$ 455,790.73	$ 407,544.88	$1,278,170.18	$1,206,545.03	$1,137,444.61	$1,039,295.71	$1,368,926.77	$1,067,700.48	$1,520,309.00
General insurance expense	21,422.34	66,455.10	68,387.50	67,669.95	104,899.97	145,421.48	258,022.38	395,065.37	495,157.55	604,073.36
General investment and real estate expense	-	-	35,742.10	47,322.18	52,050.17	54,742.94	62,285.32	60,496.58	55,114.44	55,892.56
Taxes, licenses and fees (other than income tax)	11,866.77	43,349.34	94,688.21	95,104.63	102,314.41	96,851.27	116,782.12	154,145.42	155,329.48	186,034.25
Group policy rate credits	-	-	73,914.34	(73,914.34)	-	-	-	-	-	-
Total	$ 68,000.31	$ 565,595.17	$ 680,277.03	$1,414,352.60	$1,465,609.58	$1,434,460.30	$1,476,385.53	$1,978,634.14	$1,773,301.95	$2,366,309.17
Net insurance income (loss)	$ 89,814.85	$ 336,595.30	$ 395,827.77	$ 330,670.70	$ 285,770.18	$ 546,542.12	$ 347,155.00	$ 454,854.26	$ (93,192.97)	$ (26,786.16)
Capital Gains and Losses	-	13,799.33	4,734.22	7,999.32	22,204.56	56,707.62	22,495.82	33,935.03	169,733.14	43,952.16
Net income (loss) before income tax	$ 89,814.85	$ 350,394.63	$ 400,561.99	$ 338,670.02	$ 307,974.74	$ 603,249.74	$ 369,650.82	$ 488,789.29	$ 76,540.17	$ 17,166.00
Federal Income Taxes	574.44	5,196.41	7,486.44	17,247.82	32,852.75	190,764.10	77,297.82	35,545.16	50,320.77	(104,458.74)
Net income (loss)	$ 89,240.41	$ 345,198.22	$ 393,075.55	$ 321,422.20	$ 275,121.99	$ 412,485.64	$ 292,353.00	$ 453,244.13	$ 26,219.40	$ 121,624.74
Dispositions of Income:										
Transfers to appropriated surplus	$ -	$ 14,447.59	$ 5,916.43	$ 5,593.34	$ 10,290.50	$ 25,129.38	$ 28,947.56	$ 80,539.95	$ 197,468.90	$ (173,302.12)
Dividends to stockholders--100 percent stock dividend	-	-	-	-	-	-	500,000.00	-	-	-
Total	$ -	$ 14,447.59	$ 5,916.43	$ 5,593.34	$ 10,290.50	$ 25,129.38	$ 528,947.56	$ 80,539.95	$ 197,468.90	$ (173,302.12)
Net addition to (reduction of) unrestricted retained earnings	$ 89,240.41	$ 330,750.63	$ 387,159.12	$ 315,828.86	$ 264,831.49	$ 387,356.26	$ (236,594.56)	$ 372,704.18	$ (171,249.50)	$ 294,926.86
Beginning Unrestricted Retained Earnings	-	89,240.41	419,991.04	807,150.16	1,122,979.02	1,387,810.51	1,775,166.77	1,538,572.21	1,911,276.39	1,740,026.89
Ending Unrestricted Retained Earnings	$ 89,240.41	$ 419,991.04	$ 807,150.16	$1,122,979.02	$1,387,810.51	$1,775,166.77	$1,538,572.21	$1,911,276.39	$1,740,026.89	$2,034,953.75

Life Insurance Company B
Reconciliation of Revised Earnings Statements
With Summaries of Operations and Surplus Account in the Convention Blanks

Exhibit II

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Convention Blank Figures:										
Gross income:										
Per revised earnings statement	$157,815.16	$902,190.47	$1,076,104.80	$1,745,023.30	$1,751,579.76	$1,981,002.42	$1,823,540.53	$2,433,488.40	$1,680,108.98	$2,339,523.01
Amortization of bond premium and discount	(420.41)	117.74	418.86	(465.84)	(1,525.10)	349.25	1,553.92	(263.16)	-	-
Charge to self for rent of home office	-	-	4,949.52	5,944.80	5,944.80	5,944.80	18,231.75	18,231.75	19,920.70	38,499.48
Per Convention Blank	$157,394.75	$902,308.21	$1,081,473.18	$1,750,502.26	$1,755,999.46	$1,987,296.47	$1,843,326.20	$2,451,456.99	$1,700,029.68	$2,378,022.49
Acquisition, Investment and Administrative Expense:										
Commissions	$109,338.46	$738,709.35	$ 661,716.23	$1,427,622.31	$1,346,014.92	$1,046,582.26	$1,215,544.61	$1,657,523.29	$1,238,812.48	$1,604,456.74
General insurance expense	21,422.34	66,455.10	73,337.02	73,614.75	110,419.24	151,107.68	276,054.13	412,747.12	513,578.25	641,072.84
General investment and real estate expense	-	-	35,742.10	47,322.18	52,475.70	55,001.54	62,485.32	61,046.58	56,614.44	57,392.56
Taxes, licenses and fees (including income tax)	12,441.21	48,545.75	102,174.65	112,352.45	135,167.16	176,913.19	304,782.12	189,690.58	205,650.25	81,575.51
Group policy rate credits	-	-	73,914.34	(73,914.34)	-	-	-	-	-	-
Total expenses per Convention Blank	$143,202.01	$853,710.20	$ 946,884.34	$1,586,997.35	$1,644,077.02	$1,429,604.67	$1,858,866.18	$2,321,007.57	$2,014,655.42	$2,384,497.65
Net gain (loss) from operations per the Convention Blank	$ 14,192.74	$ 48,598.01	$ 134,588.84	$ 163,504.91	$ 111,922.44	$ 557,691.80	$ (15,539.98)	$ 130,449.42	$ (314,625.74)	$ (6,475.16)
Items entered direct to the Surplus account:										
Amortization of bond premium and discount	$ 420.41	$ (117.74)	$ (418.86)	$ 465.84	$ 1,525.10	$ (349.25)	$ (1,553.92)	$ -	$ -	$ -
Capital gains and losses on assets sold	-	13,799.33	4,734.22	7,999.32	22,204.56	56,548.91	22,495.82	33,878.78	168,417.34	43,952.16
Change in value of assets owned at end of year	-	-	250.00	(4,000.00)	(7,804.65)	(14,748.68)	41,484.60	46,061.73	121,844.08	230,935.81
Change in value of non-admitted and related items	-	-	-	-	-	-	-	-	-	-
Correction of amortization for non-eligible bonds	-	-	-	(263.16)	(244.41)	(244.41)	(244.41)	-	-	-
Total	$ 420.41	$ 13,681.59	$ 4,565.36	$ 4,202.00	$ 15,680.60	$ 41,206.57	$ 62,182.09	$ 79,940.51	$ 290,261.42	$ 274,887.97
Net per Convention Blank before items classed as "Dispositions of Income", as corrected	$ 14,613.15	$ 62,279.60	$ 139,154.20	$ 167,706.91	$ 127,603.04	$ 598,898.37	$ 46,642.11	$ 210,389.93	$ (24,364.32)	$ 268,412.81
Adjustments (see Schedule II(A) for details):										
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ -	$ -	$ -	$ -	$ -	$ 20,450.19	$ (20,450.19)	$ -	$ -	$ -
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	-	-	(250.00)	4,263.16	17,111.41	(14,360.74)	(20,790.00)	(45,742.32)	(120,528.28)	(230,935.81)
Group III--Provide for possible losses on certain assets	-	-	-	-	-	-	-	-	-	-
Group IV--Defer a portion of acquisition costs to future periods	74,627.26	282,918.62	254,171.35	149,452.13	139,469.89	(90,862.35)	176,248.90	288,596.52	171,112.00	84,147.74
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at cost less depreciation	-	-	-	-	-	-	-	-	-	-
Group VI--Transfer certain losses and expenses to the proper year	-	-	-	-	(9,062.35)	(101,639.33)	110,702.18	-	-	-
Total adjustments	$ 74,627.26	$282,918.62	$ 253,921.35	$ 153,715.29	$ 147,518.95	$ (186,412.23)	$ 245,710.89	$ 242,854.20	$ 50,583.72	$ (146,788.07)
Net income (loss) per revised earnings statement	$ 89,240.21	$345,198.22	$ 393,075.55	$ 321,422.20	$ 275,121.99	$ 412,486.14	$ 292,353.00	$ 453,244.13	$ 26,219.40	$ 121,624.74
Difference Between Net Gain From Operations per the Convention Blank and Net Income per the Revised Earnings Statement	$ 75,047.67	$296,600.21	$ 258,486.71	$ 157,917.29	$ 163,199.55	$ (145,205.66)	$ 307,892.98	$5 322,794.71	$ 340,845.14	$ 128,099.90

Life Insurance Company B
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule II(A)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):										
4. Agents' debit balances	$ -	$ -	$ -	$ -	$ -	$ 20,450.19	$(20,450.19)	$ -	$ -	$ -
Total Group I adjustments	$ -	$ -	$ -	$ -	$ -	$ 20,450.19	$(20,450.19)	$ -	$ -	$ -
Group II--Reverse revaluation of securities to N.A.I.C. values, thus returning them to amortized cost:										
20. Bonds	$ -	$ -	$ (250.00)	$ 4,000.00	$ 16,867.00	$ (14,763.86)	$ 2,255.28	$ 3,723.15	$ (25.36)	$ (20,510.50)
21. Stocks	-	-	-	-	-	-	(23,289.69)	(49,784.88)	(121,818.72)	(210,425.31)
23. Amortization on bonds "not eligible"	-	-	-	263.16	244.41	244.41	244.41	263.16	-	-
25. Change in capital gains as a result of other adjustments in this group	-	-	-	-	-	158.71	-	56.25	1,315.80	-
Total Group II adjustments	$ -	$ -	$ (250.00)	$ 4,263.16	$ 17,111.41	$ (14,360.74)	$(20,790.00)	$(45,742.32)	$(120,528.28)	$(230,935.81)
Group III--Provide for possible losses on certain assets	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Group IV--Defer a portion of acquisition costs to future periods:										
40. First year life insurance commissions (arbitrarily allocated evenly over a five-year period)	$ -	$ 8,452.95	$ 17,082.38	$ (4,939.28)	$ (6,921.95)	$ (5,197.48)	$ 83,586.57	$177,590.41	$ 181,295.47	$ 129,832.63
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	12,451.36	33,058.99	13,937.04	36,000.00	94,846.19	52,130.32	40,825.96	63,737.63	(2,520.47)	28,475.87
42. Accident and health insurance direct acquisition costs (deferred in same manner as Item 41)	-	-	-	-	-	-	-	-	-	-
43. Single premium credit life insurance commissions (deferred in same manner as Item 41)	62,175.90	241,406.68	223,151.93	118,391.41	51,545.65	(137,795.19)	51,836.37	47,268.48	(7,663.00)	(74,160.76)
Total Group IV adjustments	$74,627.26	$282,918.62	$254,171.35	$149,452.13	$139,469.89	$ (90,862.35)	$176,248.90	$288,596.52	$ 171,112.00	$ 84,147.74
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at cost less depreciation	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Group VI--Transfer certain losses and expenses to the proper year:										
60. Retroactive income tax on 1958 income	$ -	$ -	$ -	$ -	$ -	$(110,702.18)	$110,702.18	$ -	$ -	$ -
61. Error in listing amortized value of bond	-	-	-	-	(9,062.85)	9,062.85	-	-	-	-
Total Group VI adjustments	$ -	$ -	$ -	$ -	$ (9,062.85)	$(101,639.33)	$110,702.18	$ -	$ -	$ -
Total Effect of All Adjustments on Income	$74,627.26	$282,918.62	$253,921.35	$153,715.29	$147,518.45	$(186,412.23)	$245,710.89	$242,854.20	$ 50,583.72	$(146,788.07)

Life Insurance Company B
Balance Sheet Extended to Conform With "Generally Accepted Accounting Principles"
December 31, 1962

Exhibit III

ASSETS

	N.A.I.C. Value		Amortized Cost
Assets Admitted As Legal Investments of Insurance Reserves:			
Revenue-producing assets:			
Bonds	$3,889,020.82		$3,921,837.53
Stocks	797,857.98		813,390.00
Mortgage loans on real estate	24,500.06		24,500.06
Policy loans	18,107.56		18,107.56
Rental portion of home office building (see below)	537,424.11		537,424.11
Total valuation prescribed by National Association of Insurance Commissioners (N.A.I.C.)	$5,266,910.53		
Total invested in revenue-producing assets			$5,315,259.26
Operating assets--at cost adjusted for amortization and depreciation, which is also the valuation prescribed by the National Association of Insurance Commissioners:			
Current assets:			
Cash		$ 991,411.39	
Receivables from reinsurers		1,052.06	
Receivables from affiliated companies		90,375.00	
Accident and health insurance premiums receivable		123,577.02	
Accrued interest receivable		46,630.42	1,253,045.89
Home office building:			
Cost		$1,103,586.66	
Cumulative portion charged to depreciation		28,738.44	
Effective amount invested in home office		$1,074,848.22	
Deduct portion applicable to part rented to others, so included in revenue-producing assets above		537,424.11	537,424.11
Total invested in admitted assets			$7,105,729.26
Operating Assets Which Do Not Qualify As Admitted Assets:			
Costs deferred to future periods:			
First year life insurance commissions		$ 580,781.70	
Accident and health commissions		372,942.89	
Single premium credit insurance commissions		576,157.47	
Total invested in non-admitted assets			1,529,882.06
Total invested in all assets			$8,635,611.32

LIABILITIES and INVESTMENT

Portion of Premiums and Investment Income Held As Reserves:			
Aggregate policy reserves:			
On life policies and contracts:			
Total actuarial reserves		$2,565,013.40	
Deduct reserve on deferred and uncollected premiums:			
Total (net of loading)	$ 259,039.78		
Estimated "cost of collection" in excess of loading on these premiums	31,383.63	227,656.15	
Reserve on premiums collected		$2,337,357.25	
On accident and health policies		1,538,875.51	$3,876,232.76
Reserve on supplemental contracts without life contingencies			4,980.00
Premium deposit funds			22,311.59
Total statutory insurance reserves			$3,903,524.35
Current Liabilities:			
Policy and contract claims		$ 573,769.46	
Claim drafts outstanding		29,423.62	
Accrued commissions payable		196,939.69	
Accounts payable for general expenses		25,313.35	
Accrued taxes		159,324.14	
Unearned investment income		2,515.27	
Payroll taxes payable		2,705.63	
Remittances not allocated		204,724.11	1,194,715.27
Total liabilities			$5,098,239.62
Legal Capital:			
Capital stock--40,000 shares at $25 par		$1,000,000.00	
Surplus--N.A.I.C. valuation of admitted assets over liabilities, capital stock and appropriations		656,722.96	
Total legal "policyholder surplus"		$1,656,722.96	
Surplus appropriated for special purposes:			
Mandatory securities valuation reserve	$ 195,031.53		
Group contingency reserve	107,386.42	302,417.95	
Total based on National Association of Insurance Commissioners valuation of admitted assets		$1,959,140.91	
Add unrealized loss in N.A.I.C. valuation of assets:			
Amortized cost of revenue-producing assets	$5,315,259.26		
N.A.I.C. valuation of revenue-producing assets	5,266,910.53	48,348.73	2,007,489.64
Total legal investment			$7,105,729.26
Investment by Stockholders:			
Amount paid-in for capital stock:			
Capital stock--40,000 shares at $25 par	$1,000,000.00		
Premium on capital stock	200,000.00	$1,200,000.00	
Retained earnings:			
Appropriated for special purposes--as above	$ 302,417.95		
Unrestricted--per earnings statement	2,034,953.75	2,337,371.70	
Total investment by stockholders		$3,537,371.70	
Deduct portion included in legal reserve capital above		2,007,489.64	
Net investment of funds provided by stockholders in non-admitted assets			1,529,882.06
Total liabilities and investment			$8,635,611.32

COMPANY C

History

Growth

Life Insurance Company C is a relatively small stock life insurance company which has followed highly conservative policies and has grown steadily over a fifty-six year period. The following tabulation summarizes that growth by ten-year intervals:

Year	Premiums Written During Year	Total Insurance Reserves	Total Assets[1]
1912	$ 154,000	$ 233,000	$ 428,000
1922	459,000	1,907,000	2,336,000
1932	539,000	3,782,000	5,058,000
1942	564,000	4,589,000	5,772,000
1952	1,603,000	8,016,000	11,093,000
1962	4,006,000	19,279,000	23,433,000

Underwriting and reserves

The company is authorized to write insurance in twelve states. It writes the usual types of life insurance, including eight special policies, and accident and health insurance. As can be seen in Exhibit I, the latter comprises a relatively small but nevertheless important portion of total business. No annuity contracts are written. The ordinary life insurance reserves at December 31, 1962, as summarized from Section A of Exhibit 8 of the Convention Blank, were comprised of:

Modified preliminary term methods:	
Illinois Standard	19.2%
Commissioners Reserve Valuation Method (CRVM)	35.7
Special modified	11.3
Total	66.2%
Net level methods	133.8
	100.0%

[1]At N.A.I.C. valuations but including non-admitted assets through 1952. The 1962 figure is the total invested in assets as shown in Exhibit III.

In view of this extensive use of modified preliminary term reserve methods, the possibility of over-adjustment on first-year life insurance commissions, which is pointed out in the discussion of Adjustment 30 in Chapter III, should be kept in mind as the statements of Company C are studied.

Stockholders and stock prices

There were 186 stockholders on December 31, 1962. The price range of the stock during the past three years was:[1]

Year	High	Low
1960	48	39 3/4
1961	90	62
1962	111	82 1/2

The company sends a printed condensed financial statement to each stockholder and policyholder at the end of the year, but more detailed multilithed statements containing a three-year comparison are handed out at the stockholders meeting. A detailed financial analysis is prepared by independent CPA's for management each quarter.

Special Study

The foregoing data indicate that, unlike Companies A and B whose operations are specialized, Company C is a typical regional life insurance company. It was, therefore, selected for special analysis. The financial data in the Convention Blanks for each year were summarized into comparative worksheet statements from the date of incorporation in 1906 until the start of the detailed worksheets in 1953. This process was time consuming but helped provide an understanding of the development of the

[1] Best's Life Insurance Reports - 1963 (New York: Alfred M. Best Company, Inc., 58th annual edition)

Convention Blank and forced a detailed scrutiny of the specific changes made year by year in that blank. This material is drawn on extensively for the historical review in Chapter II, but there is little to be gained from inclusion of the revised statements for the entire period at this point. The same ten-year period is, therefore, used in the financial statements included in this chapter as is used for the other companies.

The analysis for the entire period served another purpose also. It substantiated the methods used to compute the January 1, 1953, adjustments which are required in order to have an accurate starting point for the revised and extended statements. Such items as furniture and equipment, for example, were scheduled on a depreciation analysis sheet for the entire fifty-six year period. The methods used to obtain the January 1, 1953, balances for the other firms were also completed for Company C and compared with the detailed analysis. The same balances were obtained, thus substantiating the method used.

Adjustments Not Previously Discussed

Adjustment 9. Returned checks

This non-admitted asset belongs in the extended balance sheet so long as circumstances are such that the company expects to collect from the makers of the checks.

Adjustment 10. Miscellaneous suspense debits

This item encompasses small items of expenditures which pertain to future periods. As such it should be included in a balance sheet which conforms with generally accepted accounting principles.

Adjustment 24. Stock in subsidiary corporation

For purposes of the Convention Blank, stock in a subsidiary corporation is included with the stock of other corporations and is carried at the net book value of that stock.[1] This net book value is arrived at by subjecting the subsidiary company to the same valuation process used in computing the Convention Blank balance sheet of the parent company.

Company C wrote down the book value of the stock in its subsidiary to $1 in 1945. In 1961, the examiners convinced the company that this stock should be carried on the books at its original cost of $10,000 and the stock was written up to this figure. The offsetting $9,999 is entered in the Surplus account and is part of the "Other Adjustments of Book Value" shown in Exhibit II herein. The stock continues to be shown in the Convention Blank balance sheet at its computed market value, as recommended by the examiners, and the change from year to year is included in the summary of the Surplus account as an unrealized capital gain or loss item. The adjustments in this study are designed to state the stock at the amount invested in it. This is appropriate for Company C because, although the subsidiary was originally created for the purpose of carrying premium notes from the agents of the parent company, it has been largely inactive during recent years, its only assets being cash and securities and its only income the interest and dividends on these securities.

Adjustment 53. Reverse write-up of value of land and buildings

Since the fixed asset accounts are stated at cost less depreciation in the revised statements herein, any later adjustments in the book value by the company must be reversed.

---

[1]This method is urged in the 1960 examination report on Company C.

Adjustment 54. Reverse placing of value of furniture and equipment on the books by the company

Company C charged the cost of all acquisitions of furniture and equipment to expense until 1960. At that time, all of these items were inventoried and entered on the books. Since the revised statements already show these items at cost less depreciation, the company entry must be reversed.

The flat 10 per cent depreciation rate used in this study naturally does not exactly agree with the inventory value recorded by the Company in 1960. In order to have the net value on December 31, 1959, agree with the amount recorded by the company on January 1, 1960, the difference of $2,344.51 is spread back over the preceding six years. This makes the revised statements and the Convention Blank agree at the time the firm capitalized its furniture and equipment. The company's depreciation is accepted thereafter.

Adjustment 62. Eliminate excessive accrual of income taxes

Company C followed a plan of estimating its Federal income tax liability at a round amount of $20,000, then $25,000 and finally $50,000 at the end of each year from 1954 through 1959. When the estimate was reasonably close to the taxes actually paid in the following year, no adjustment is made herein. However, $50,000 was set up as a liability for Federal income taxes at the end of 1958 but only $639.05 was paid in 1959. A small refund was obtained in 1960. So, the excessive accrual is reversed for those years.

Adjustment 63. Past services portion of pension plan

Company C transferred $175,000 from Surplus to a special Reserve for Employees' Retirement Plan in 1954. In 1962 the plan was extended and a Surplus charge of $72,555.99 for past services was made. The required addition to the reserve is charged to expense each year. This is acceptable accounting.

The method of handling the original contribution to the reserve and the increase in 1962 for past services is another matter. Under the computation of Surplus concept of the Convention Blank statements, the charge to Surplus is perfectly proper. But, from the point of view of measurement of income which is inherent in the accountability type of statements upon which generally accepted accounting principles are based, a serious question arises.

The minimum level of accounting which is acceptable to the accounting profession, as expressed in Accounting Research Bulletin 43 of the AICPA, is clearly stated in the following excerpt from that publication:

> The committee believes that, even though the calculation is based on past service, costs of annuities based on such service are incurred in contemplation of present and future services, not necessarily of the individual affected but of the organization as a whole, and therefore should be charged to the present and future periods benefited....
>
> The committee accordingly is of the opinion that:
>
> (a) Costs of annuities based on past service should be allocated to current and future periods; however, if they are not sufficiently material in amount to distort the results of operations in a single period, they may be absorbed in the current year.
>
> (b) Costs of annuities based on past service should not be charged to Surplus.[1]

---

[1]Accounting Research and Terminology Bulletins, Final Edition (New York: American Institute of Certified Public Accountants, 1961) pp. 117 and 118.

The Internal Revenue Code permits deduction of contribution of the past service portion of contributions to a pension plan over a period of not less than ten years.[1] This provides a convenient period of time to be used in this study, so the original and past service costs of pension plans are capitalized and amortized over a ten-year period. This ten-year period might, or might not, be a reasonable period for a particular firm in actual practice.

The Financial Statements

Although Company C is the first company which can be regarded as typical, most of the factors which need to be explained about the format and method of presentation of the financial statements have been covered in the discussion of Companies A and B. These statements reflect the results of the analysis of Company C better than an expository explanation.

In many respects, Exhibit II is the most significant statement because it reflects both the earnings data of the Convention Blank and the revised data. The portion of "earnings" which is reflected as an operating gain and the portion which is entered direct to Surplus in the Convention Blank is particularly interesting. Another item which warrants special attention is the bottom line of Exhibit II. The adjustments made in this study increased the net income as compared to the net gain from operations shown in the Convention Blank during the first few years, but this difference gradually decreases until the revised net income is smaller than the net gain from operations reported in the Convention Blank during the last three years. Conceivably, this might indicate that the earnings of the firm are tapering off but that this trend is not reflected in the regulatory statements

---

[1]Section 404(a)(1)(C).

because so many costs are charged to expense when incurred rather than being matched against the revenue which those expenditures help to generate. This is only a possibility which cannot be verified except through the passage of time, but is quite evident in the next company discussed (Company D).

Some Interesting Side Issues

During the process of summarizing the Convention Blank statements into comparative worksheet statements and reading the examination reports on Company C from its inception in 1906, some interesting procedures were noted which, while not followed today, shed considerable light on the underlying philosophy of insurance accounting and reporting.

Extreme conservatism

Most companies may not have been as conservative as Company C, but the 1945 examination report calls attention to a procedure which indicates how far conservatism can be carried when it is over-emphasized. That report calls attention to the fact that for several years prior to 1945 the company valued its bonds at the lower of (1) book value (amortized cost), (2) cost, (3) market, (4) call price, or (5) par. Such valuation practices would, as is now recognized, result in "income" when the bonds are brought back up to a more realistic basis or when they are sold, thus giving a non-conservative earnings computation at that time.

A startling practice was followed for several years prior to 1945. Any dividends in excess of 3 1/2 per cent of the cost of stock were applied against the book value of the stock. In 1943 that adjustment amounted to $19,336.75. While admittedly conservative, this type of procedure certainly

did not provide accurate reporting from an accountability point of view, and fortunately has been abandoned.

<u>Depreciation and rent charged self</u>

Although depreciation is currently being recorded in a conventional manner, a former home office building was not scientifically depreciated. Instead, it was carried at original cost of $380,000 for several years, then was written down as follows:

1939	$30,000
1941	20,000
1942	30,000
1943	50,000
1944	50,000

The building was carried at the remaining $200,000 until it was remodeled for rental purposes following construction of a new home office building.

Prior to occupancy of the new home office building, the company charged itself no rent. After moving into the new building, an annual charge of $32,000 was made until, in the words of the examination report, "in order to develop a more realistic charge, the rent was increased by taking 3 1/2 per cent of the mean book value of the Home Office plus depreciation expenses and taxes." Insurance companies are required to report as income a rent allowance for space used, but in the hands of a less conscientious management in a situation where the home office comprises a sizeable portion of total assets, the door is opened to manipulation of the rate earned on investments. In the revised statements in this report, as previously noted, this "rent" is eliminated and the home office is transferred out of the revenue-producing assets classification.

Life Insurance Company C
Comparative Earnings Statement
As Revised to Conform With "Generally Accepted Accounting Principles"

Exhibit I

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Revenue:										
Premiums and annuity considerations:										
Life	$1,485,448.89	$1,635,634.94	$1,859,613.57	$2,064,404.08	$2,230,739.73	$2,452,195.13	$2,636,539.09	$2,865,818.20	$3,003,582.28	$3,141,079.68
Accident and health	373,177.69	428,860.92	423,423.68	428,786.60	435,696.19	481,722.60	544,158.11	577,511.91	630,973.51	668,567.43
Consideration for supplementary contracts	216,474.74	203,142.49	216,945.28	234,728.59	243,530.37	231,289.60	227,381.28	257,026.63	347,966.74	222,507.41
Interest, rent and dividends on investments	392,691.77	412,785.57	473,974.98	521,219.12	588,602.55	636,384.18	734,966.94	801,048.02	910,451.43	973,980.43
Other operating revenue	241.66	236.65	288.10	321.42	21.00	10.18	148.71	429.58	98.81	-
Total	$2,468,034.75	$2,680,660.57	$2,974,245.61	$3,249,459.81	$3,498,589.84	$3,801,601.69	$4,143,194.13	$4,501,834.34	$4,893,072.77	$5,006,134.95
Deduct the portion:										
Set aside as policyholder reserves:										
Increase in legal reserves	$ 772,310.20	$ 764,500.07	$ 846,185.80	$ 932,473.85	$ 966,944.32	$1,186,868.48	$1,192,575.03	$1,351,378.27	$1,399,930.90	$1,341,605.27
Adjustment for expenses on increase in deferred and uncollected premiums	19,398.09	12,372.83	21,060.26	80,325.23	(10,286.00)	11,416.64	15,488.66	(51,650.78)	(7,123.28)	(4,908.21)
Returned to policyholders in the form of dividends	82,589.48	108,940.07	134,808.97	147,920.03	164,168.51	207,985.44	182,153.71	189,921.20	175,538.79	176,480.03
Total portion not revenue this year	$ 874,297.77	$ 885,812.97	$1,002,055.03	$1,160,719.11	$1,120,826.83	$1,406,270.56	$1,390,217.40	$1,489,648.69	$1,568,346.41	$1,513,177.09
Gross revenue	$1,593,736.98	$1,794,847.60	$1,972,190.58	$2,088,740.70	$2,377,763.01	$2,395,331.13	$2,752,976.73	$3,012,185.65	$3,324,726.36	$3,492,957.86
Payments on Policy Claims and Surrenders	698,508.45	726,795.12	760,882.97	920,844.24	985,335.78	965,059.57	1,056,147.66	1,226,019.90	1,445,773.43	1,574,082.27
Gross income	$ 895,228.53	$1,068,052.48	$1,211,307.61	$1,167,896.46	$1,392,427.23	$1,430,271.56	$1,696,829.07	$1,786,165.75	$1,878,952.93	$1,918,875.59
Acquisition, Investment and Administrative Expense:										
Commissions	$ 355,528.67	$ 407,433.75	$ 438,738.89	$ 487,080.54	$ 517,428.99	$ 579,168.96	$ 646,203.97	$ 689,279.80	$ 720,383.39	$ 740,732.13
General insurance expense	330,765.44	422,805.54	450,170.33	483,877.70	521,618.76	561,099.20	596,992.91	622,437.73	659,697.20	703,755.88
General investment and real estate expense	24,954.60	56,971.43	78,953.87	83,312.01	92,763.53	82,456.38	101,676.56	141,046.45	147,957.10	172,744.88
Taxes, licenses and fees (other than income tax)	44,707.06	49,610.27	58,792.34	79,767.86	72,689.91	105,598.92	59,002.31	84,650.89	110,930.37	109,351.78
Total	$ 755,955.77	$ 936,820.99	$1,026,655.43	$1,134,038.11	$1,204,501.19	$1,328,323.46	$1,403,875.75	$1,537,414.87	$1,638,968.06	$1,726,584.67
Net insurance income (loss)	$ 139,272.76	$ 131,231.49	$ 184,652.18	$ 33,858.35	$ 187,926.04	$ 101,948.10	$ 292,953.32	$ 248,750.88	$ 239,984.87	$ 192,290.92
Capital Gains and Losses	2,713.38	12,913.50	11,503.80	1,701.01	(14,110.96)	5,231.79	551.90	631.82	1,749.31	2,395.54
Net income (loss) before income tax	$ 141,986.14	$ 144,144.99	$ 196,155.98	$ 35,559.36	$ 173,815.08	$ 107,179.89	$ 293,505.22	$ 249,382.70	$ 241,734.18	$ 194,686.46
Federal Income Taxes	12,211.41	25,065.21	17,919.36	29,658.88	27,044.71	4,706.30	-	3,951.73	8,936.87	28,768.10
Net income (loss)	$ 129,774.73	$ 119,079.78	$ 178,236.62	$ 5,900.48	$ 146,770.37	$ 102,473.59	$ 293,505.22	$ 245,430.97	$ 232,797.31	$ 165,918.36
Dispositions of Income:										
Transfers to appropriated surplus	$ (1,852.80)	$ 39,574.26	$ 7,824.06	$ 4,696.62	$ (3,042.34)	$ 87,489.75	$ 39,416.58	$ 27,789.43	$ 299,683.59	$ (19,752.96)
Cash dividends to stockholders	36,000.00	36,000.00	36,000.00	36,000.00	36,000.00	36,000.00	36,000.00	45,000.00	45,000.00	60,000.00
Stock dividends to stockholders	-	-	-	-	-	-	-	-	300,000.00	-
Total dispositions of income	$ 34,147.20	$ 75,574.26	$ 43,824.06	$ 40,696.62	$ 32,957.66	$ 123,489.75	$ 75,416.58	$ 72,789.43	$ 644,683.59	$ 40,247.04
Net addition to (reduction of) unrestricted retained earnings	$ 95,627.53	$ 43,505.52	$ 134,412.56	$ (34,796.14)	$ 113,812.71	$ (21,016.16)	$ 218,088.64	$ 172,641.54	$ (411,886.28)	$ 125,671.32
Beginning Unrestricted Retained Earnings	1,257,209.84	1,352,837.37	1,396,342.89	1,530,755.45	1,495,959.31	1,609,772.02	1,588,755.86	1,806,844.50	1,979,486.04	1,567,599.76
Ending Unrestricted Retained Earnings	$1,352,837.37	$1,396,342.89	$1,530,755.45	$1,495,959.31	$1,609,772.02	$1,588,755.86	$1,806,844.50	$1,979,486.04	$1,567,599.76	$1,693,271.08

Life Insurance Company C
Reconciliation of Revised Earnings Statements
With Summaries of Operations and Surplus Account in the Convention Blanks

Exhibit II

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Convention Blank Figures:										
Gross income:										
Per revised earnings statement	$895,228.53	$1,068,052.48	$1,211,307.61	$1,167,896.46	$1,392,427.23	$1,430,271.56	$1,696,829.07	$1,786,165.75	$1,878,952.93	$1,918,875.59
Adjustment of book values treated as capital gains	-	-	-	-	-	-	-	21,081.62	304.67	28,622.46
Charge to self for rent of home office	-	-	32,000.00	32,000.00	26,000.00	32,000.00	32,000.00	58,955.95	63,982.79	69,317.66
Per Convention Blank	$895,228.53	$1,068,052.48	$1,243,307.61	$1,199.896.46	$1,418,427.23	$1,462,271.56	$1,728,829.07	$1,866,203.32	$1,943,240.39	$2,016.815.71
Acquisition, Investment and Administrative Expense:										
Commissions	$415,800.03	$ 464,772.84	$ 512,038.02	$ 553,072.63	$ 596,513.40	$ 617,880.69	$ 676,567.32	$ 756,138.67	$ 706,153.72	$ 689,640.72
General insurance expense	347,858.20	462,440.57	454,393.32	488,773.09	521,982.06	570,767.60	602,925.76	661,428.15	697,113.61	815,779.11
General investment and real estate expense	24,954.60	56,971.43	80,553.87	84,912.01	92,763.53	82,456.38	101,676.56	141,046.45	154,945.73	180,504.05
Taxes, licenses and fees (including income tax)	56,918.47	74,675.48	76,711.70	109,426.74	99,734.62	159,666.17	59,641.36	38,602.62	119,867.24	138,119.88
Total expenses per Convention Blank	$845,531.30	$1,058,860.32	$1,123,696.91	$1,236,184.47	$1,310,993.61	$1,430,770.84	$1,440,811.00	$1,597,215.89	$1,678,080.30	$1,824,043.76
Net gain (loss) from operations per the Convention Blank	$ 49,697.23	$ 9,192.16	$ 119,610.70	$ (36,288.01)	$ 107,433.62	$ 31,500.72	$ 288,018.07	$ 268,987.43	$ 265,160.09	$ 192,771.95
Items entered direct to the Surplus account:										
Establishment of the pension plan	$ -	$ (175,000.00)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Capital gains and losses on securities sold	2,713.38	11,637.90	11,503.80	1,701.01	(14,110.96)	5,231.79	551.90	631.82	1,749.31	2,395.54
Change in value of assets owned at end of year	10,035.16	283,325.76	100,795.84	(16,468.91)	(91,916.75)	319,147.97	124,813.43	58,191.91	368,508.80	162,033.07
Change in value of non-admitted and related items	(4,367.26)	(24,160.40)	(17,683.71)	(43,748.04)	(41,829.32)	(42,188.00)	(18,688.29)	(120,733.23)	(39,263.57)	(2,272.08)
Other adjustments of book values	-	59,577.39	-	-	-	-	-	53,812.14	(304.67)	(28,622.46)
Total	$ 8,381.28	$ 155,380.65	$ 94,615.93	$ (58,515.94)	$ (147,857.03)	$ 282,191.76	$ 106,677.04	$ (8,097.36)	$ 330,689.87	$ 133,534.07
Net per Convention Blank before items classed as "Dispositions of Income", as corrected	$ 58,078.51	$ 164,572.81	$ 214,226.63	$ (94,803.95)	$ (40,423.41)	$ 313,692.48	$ 394,695.11	$ 260,890.07	$ 595,849.96	$ 326,306.02
Adjustments (see Schedule II(A) for details):										
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 4,367.26	$ 24,160.40	$ 17,683.71	$ 43,748.04	$ 41,829.32	$ 42,188.00	$ 18,688.29	$ 48,164.23	$ 34,915.47	$ 5,814.34
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	(10,035.16)	(205,413.63)	(100,795.84)	16,468.91	91,916.75	(319,147.97)	(124,813.43)	(58,191.91)	(368,508.80)	(162,033.07)
Group III--Provide for possible losses on certain assets	(436.73)	(2,416.04)	(1,768.37)	(4,374.80)	(4,182.93)	(4,218.80)	(1,868.83)	(4,752.97)	(3,452.37)	(497.26)
Group IV--Defer a portion of acquisition costs to future periods	69,532.69	55,697.78	71,077.71	63,682.03	81,567.62	37,786.02	30,318.96	69,146.31	(12,855.05)	(47,929.80)
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	8,268.16	(75,021.54)	(4,687.22)	(1,319.75)	(6,436.98)	312.91	(6,653.93)	(2,344.76)	4,348.10	(3,542.26)
Group VI--Transfer certain losses and expenses to the proper year	-	157,500.00	(17,500.00)	(17,500.00)	(17,500.00)	31,860.95	(16,860.95)	(67,500.00)	(17,500.00)	47,800.39
Total adjustments	$ 71,696.22	$ (45,493.03)	$ (35,990.01)	$ 100,704.43	$ 187,193.78	$ (211,218.89)	$ (101,189.89)	$ (15,459.10)	$ (363,052.65)	$ (160,387.66)
Net income (loss) per revised earnings statement	$129,774.73	$ 119,079.78	$ 178,236.62	$ 5,900.48	$ 146,770.37	$ 102,473.59	$ 293,505.22	$ 245,430.97	$ 232,797.31	$ 165,918.36
Difference Between Net Gain From Operations per the Convention Blank and Net Income per the Revised Earnings Statement	$ 80,077.50	$ 109,887.62	$ 58,625.92	$ 42,188.49	$ 39,336.75	$ 70,972.87	$ 5,487.15	$ (23,556.46)	$ (32,362.78)	$ (26,853.59)

Life Insurance Company C
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule II(A)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):										
2. Advances to officers and agents	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 500.00	$ 200.00
3. Loans considered inadmissible	-	-	-	-	-	-	-	-	-	455.57
4. Agents' debit balances	4,367.26	24,160.40	17,683.71	43,748.04	41,829.32	42,188.00	18,688.29	47,529.67	34,523.69	4,972.57
9. Returned checks	-	-	-	-	-	-	-	654.56	(108.22)	110.95
10. Miscellaneous suspense debits	-	-	-	-	-	-	-	-	-	75.25
Total Group I adjustments	$ 4,367.26	$ 24,160.40	$ 17,683.71	$ 43,748.04	$ 41,829.32	$ 42,188.00	$ 18,688.29	$ 48,184.23	$ 34,915.47	$ 5,814.34
Group II--Reverse revaluation of securities to N.A.I.C. values, thus returning them to amortized cost:										
20. Bonds	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
21. Stocks	(11,376.04)	(201,918.70)	(95,618.21)	16,428.28	90,473.87	(326,384.67)	(137,285.87)	(37,502.40)	(368,508.80)	(162,033.07)
22. Mortgage loans	-	-	-	-	-	-	-	-	-	-
24. Stock in subsidiary corporation	1,340.88	(4,770.53)	(5,177.63)	40.63	1,442.88	(1,461.83)	5,483.67	(5,002.21)	-	-
25. Change in capital gains as a result of previous adjustments in this group	-	1,275.60	-	-	-	8,698.53	6,988.77	(15,687.30)	-	-
Total Group II adjustments	$(10,035.16)	$(205,413.63)	$(100,795.84)	$ 16,468.91	$ 91,916.75	$(319,147.97)	$(124,813.43)	$(58,191.91)	$(368,508.80)	$(162,033.07)
Group III--Provide for possible losses on certain assets:										
30. Agents' debit balances (estimated at 10 percent)	$ (436.73)	$ (2,416.04)	$ (1,768.37)	$ (4,374.80)	$ (4,182.93)	$ (4,218.80)	$ (1,868.83)	$ (4,752.97)	$ (3,452.37)	$ (497.26)
Group IV--Defer a portion of acquisition costs to future periods:										
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$ 53,906.25	$ 57,741.04	$ 76,320.34	$ 71,316.10	$ 71,925.36	$ 36,088.54	$ 40,103.27	$ 67,324.70	$ (16,984.18)	$ (53,415.62)
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	7,197.78	321.40	(3,021.21)	(5,324.01)	7,159.05	2,623.19	(9,739.92)	(465.83)	2,754.51	2,324.21
42. Accident and health insurance direct acquisition costs (deferred in same manner as Item 41)	8,428.66	(2,364.66)	(2,221.42)	(2,310.06)	2,483.21	(925.71)	(44.39)	2,287.44	1,374.62	3,161.61
Total Group IV adjustments	$ 69,532.69	$ 55,697.78	$ 71,077.71	$ 63,682.03	$ 81,567.62	$ 37,786.02	$ 30,318.96	$ 69,146.31	$ (12,855.05)	$ (47,929.80)
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:										
50. Record furniture and equipment as an asset	$ 13,163.04	$ 67,268.70	$ 4,690.54	$ 8,325.82	$ 3,275.60	$ 10,274.93	$ 3,539.73	$ -	$ -	$ -
51. Record depreciation of furniture and equipment	(4,894.88)	(6,076.32)	(9,377.76)	(9,645.57)	(9,712.58)	(9,962.02)	(10,193.66)	-	-	-
52. Reverse entry for change in net book value of furniture and equipment	-	-	-	-	-	-	-	(74,893.76)	4,348.10	(3,542.26)
53. Reverse write-up of value of land and buildings	-	(136,213.92)	-	-	-	-	-	-	-	-
54. Reverse placing of value of furniture and equipment on the books by the company	-	-	-	-	-	-	-	72,549.00	-	-
Total Group V adjustments	$ 8,268.16	$ (75,021.54)	$ (4,687.22)	$ (1,319.75)	$ (6,436.98)	$ 312.91	$ (6,653.93)	$ (2,344.76)	$ 4,348.10	$ (3,542.26)
Group VI--Transfer certain losses and expenses to the proper year:										
62. Eliminate excessive accrual of income taxes	$ -	$ -	$ -	$ -	$ -	$ 49,360.95	$ 639.05	$(50,000.00)	$ -	$ -
63. Past services portion of pension plan	-	157,500.00	(17,500.00)	(17,500.00)	(17,500.00)	(17,500.00)	(17,500.00)	(17,500.00)	(17,500.00)	47,800.39
Total Group VI adjustments	$ -	$ 157,500.00	$ (17,500.00)	$(17,500.00)	$(17,500.00)	$ 31,860.95	$ (16,860.95)	$(67,500.00)	$ (17,500.00)	$ 47,800.39
Total Effect of All Adjustments on Income	$ 71,696.22	$ (45,493.03)	$ (35,990.01)	$100,704.43	$187,193.78	$(211,218.89)	$(101,189.89)	$(15,459.10)	$(363,052.65)	$(160,387.66)

Life Insurance Company C
Balance Sheet Extended to Conform With "Generally Accepted Accounting Principles"
December 31, 1962

Exhibit III

ASSETS

	N.A.I.C. Value	Amortized Cost	
Assets Admitted As Legal Investments of Insurance Reserves:			
Revenue-producing assets:			
Bonds	$10,426,030.41		$10,426,030.41
Stocks	2,008,739.70		948,470.50
Stock in subsidiary corporation	37,700.00		10,000.00
Mortgage loans on real estate	7,922,754.83		7,922,754.83
Rental real estate:	725,753.71		
Cost		$860,361.67	
Cumulative portion charged to depreciation		129,807.96	730,553.71
Policy loans	1,359,566.15		1,359,566.15
Total valuation prescribed by National Association of Insurance Commissioners (N.A.I.C.)	$22,480,544.80		
Total invested in revenue-producing assets			$21,397,375.60
Operating assets--at cost adjusted for amortization and depreciation, which is also the N.A.I.C. valuation:			
Current assets:			
Cash		$162,242.37	
Receivables and sundry current assets		229,008.36	391,250.73
Home office building:			
Cost		$490,000.00	
Cumulative portion charged to depreciation expense		102,267.00	387,733.00
Total invested in admitted assets			$22,176,359.33
Operating Assets Which Do Not Qualify As Admitted Assets:			
Current assets:			
Agents' debit balances:			
Aggregate of all agents' debit2balances	$ 331,233.51		
Deduct estimated uncollectible portion	33,123.35	$298,110.16	
Other receivables and sundry current assets		1,432.54	$ 299,542.70
Loans on personal security			455.57
Furniture and equipment:			
Cost		$139,716.10	
Cumulative portion charged to depreciation expense		66,361.26	73,354.84
Costs deferred to future periods:			
First year life insurance commissions		$743,641.24	
Accident and health insurance commissions		45,477.56	
Accident and health insurance acquisition costs		11,733.49	
Past services portion of initial contribution to pension plan		82,800.39	883,652.68
Total invested in non-admitted assets			$ 1,257,005.79
Total invested in all assets			$23,433,365.12

LIABILITIES and INVESTMENT

Portion of Premiums and Investment Income Held As Reserves:			
Aggregate policy reserves:			
On life policies and contracts:			
Total actuarial reserves		$17,043,857.68	
Deduct reserve on deferred and uncollected premiums		737,091.00	
Reserve on premiums collected		$16,306,766.68	
On accident and health policies		242,758.96	
Reserve on supplemental contracts without life contingencies		693,987.30	$17,243,512.94
Policyholders' dividend and coupon accumulations			1,456,932.55
Premium deposit funds			169,177.39
Total statutory policyholder reserves			$18,869,622.88
Liability for Benefits for Employees and Agents			409,147.04
Total statutory insurance reserves			$19,278,769.92
Operating Liabilities:			
Notes payable (to take advantage of investment opportunity):			
Face amount of notes		$ 500,000.00	
Accrued interest		2,396.53	520,396.53
Current liabilities:			
Policy and contract claims		$ 154,453.63	
Policyholder dividends and coupons payable in 1963		67,889.64	
Payables and sundry current liabilities		326,258.13	548,601.40
Total liabilities			$20,329,767.85
Legal Capital:			
Capital stock--60,000 shares at $10 par		$ 600,000.00	
Surplus--N.A.I.C. valuation of admitted assets over liabilities, capital stock and appropriations		1,615,934.49	
Total legal "policyholder surplus"		$ 2,215,934.49	
Appropriation of Surplus for Mandatory Securities Valuation Reserve		713,826.19	
Total based on N.A.I.C. valuation of admitted assets		$ 2,929,760.68	
Deduct unrealized increment in N.A.I.C. valuation of assets:			
N.A.I.C. valuation of revenue-producing assets	$22,480,544.80		
Amortized cost of revenue-producing assets	21,397,375.60	1,083,169.20	1,846,591.48
Total legal investment			$22,176,359.33
Investment by Stockholders:			
Amount paid-in for capital stock (including stock dividends):			
Capital stock--60,000 shares at $10 par		$ 600,000.00	
Premium on capital stock (net of $11,800 returned prior to 1923)		96,500.00	$ 696,500.00
Retained earnings:			
Portion appropriated for Mandatory Securities Valuation Reserve		$ 713,826.19	
Unrestricted--per revised earnings statement		1,693,271.08	2,407,097.27
Total investment by stockholders			$ 3,103,597.27
Deduct portion included in legal reserve capital above			1,846,591.48
Net investment of funds provided by stockholders in non-admitted assets			$ 1,257,005.79
Total liabilities and investment			$23,433,365.12

COMPANY D

History

Highlights

Life Insurance Company D is the only company studied which suffered substantial decreases in business. These decreases provide a limited test of the effectiveness of the revised statements as a measurement of earnings when volume is decreasing.

Although Life Insurance Company D was formed seventeen years ago, growth was slow until 1957. At that time, several district offices were opened and the accident and health business was expanded. As can be seen in Exhibit I, this expansion was financed through "surplus notes." In 1958 it was necessary to close many of the district offices and generally to curtail expenditures, with a corresponding decrease in volume. A substantial block of new stock was issued in 1960, the surplus notes were paid off, and the company expanded into the credit insurance field. Volume has tripled since that time.

Underwriting and reserves

Modified preliminary term reserve methods have been used for almost all reserve computations, only 1.9% of the reserves being computed on a net level basis. Consequently, warnings sounded previously about the probability of over-adjustment for first-year life insurance commissions and about the effect of the reserve methods followed on earnings are especially pertinent to Company D.

Adjustments Not Previously Discussed

Adjustment 11. College Plan notes

These notes are a special feature of certain policies. Since they are not included in the categories of items which are specifically approved as legal investments of insurance reserves, they are treated as a non-admitted item in the Convention Blank. For purposes of statements emphasizing accountability, the amount invested in notes of this kind should be included in assets so long as there is reasonable belief on the part of management that they are collectible. If experience indicates that some losses are likely, a valuation reserve should be established for managements best estimate of the likely loss. Adjustment 31 includes such provision.

Adjustment 12. Deposit in industrial bank

The company has $122,000 on deposit in an industrial bank which is in financial difficulty. The entire amount is non-admitted. Under generally accepted accounting principles, by contrast, the amount on deposit should be shown in the balance sheet but a provision for the expected loss should be established and be deducted from the asset account. In this way the stockholder has complete information regarding both what has been done with company funds and management's estimate of the probable loss. This adjustment reinstates the deposit to assets and provision for loss is established with Adjustment 31.

Adjustment 22. Mortgage loans

A mortgage loan was written down in 1961 but brought back up to face value in 1962. These entries are reversed with Adjustment 22.

Adjustment 31. Provision for loss on non-admitted current assets

Provision for possible losses in connection with the deposit in the industrial bank and on other non-admitted current assets is established with this adjustment. Since the purpose of this study is to test the feasibility of methods which are acceptable under generally accepted accounting principles, the amount of the provision is an arbitrary figure selected without consulting management of the firm. In practice, the amount of this provision would be determined by high-level management and should be their best estimate of the probable loss.

Adjustment 32. Provision for loss on stock in other insurance companies

This adjustment is of the same nature as Adjustment 31 in that it is arbitrary in amount but is intended to demonstrate a method which could be acceptable under generally accepted accounting principles. Instead of considering the entire stock issue a non-admitted asset, the cost of the stock is reinstated to the balance sheet in Adjustment 21 and the expected loss is deducted through Adjustment 32. As in the case of Adjustment 31, the provision is an arbitrary amount selected without consulting management of the firm.

Adjustment 55. Record depreciation on home office building

Adjustment 56. Reverse company's write down in lieu of depreciation

Company D purchased a building during its first year. However, this building was carried at cost during the first four years of the company's operations. After that, the building was written down each year, first at

the rate of $1,000 a year, later at the rate of $500 a year. Under generally accepted accounting principles as now applied, the cost of the building should be charged to operations through systematic depreciation charges without regard to the profits of the particular year. Adjustment 55 records such depreciation, using a 3 per cent straight line rate. Adjustment 56 reverses the company's write downs.

Adjustment 57. Change in capital gains as a result of previous adjustments in this group

The difference between the depreciation recorded through Adjustment 55 and the write downs made by the company changes the capital gain when the home office was sold. A similar adjustment of capital gains is necessary when the furniture and equipment in the offices which were closed in 1958 were sold.

Adjustment 58. Record cost of credit insurance agencies as an asset

Adjustment 59. Record amortization of cost of credit insurance agencies

Method used in Convention Blank.--The regulatory system requires that expenditures of the nature covered by these adjustments be charged to Surplus, either directly or through the process of considering the expenditure a non-admitted asset. Company D amortizes the cost of the agency purchased in 1960 at the rate of $6,000 per year. The balance is considered a non-admitted asset each year. Consequently, the amortization each year is offset by the gain from change in value of non-admitted assets, and Surplus is not affected after absorbing the entire cost in the year of acquisition.

The portion of the cost of the agency purchased at the end of 1962 in excess of the value of specific assets acquired was charged directly to Surplus rather than being set up as a non-admitted asset. Since it was purchased at the end of the year, no amortization is involved.

Generally accepted accounting principles.--The purchase of these credit agencies is really a purchase of goodwill. At one time it was not uncommon for commercial and industrial firms to show intangible assets such as goodwill at a nominal figure of $1 and to charge all the rest of the cost against Earned Surplus. Today, the cost of purchased goodwill is universally recognized as an asset.[1] However, accountants are not in full agreement as to whether or not such costs should be amortized. Until twenty years or so ago, the prevalent accounting philosophy was that purchased goodwill should remain on the books forever unless the excess earning capacity was clearly diminishing. There seems to be a strong current tendency, however, toward amortization over a reasonable time.[2] For

---

[1]For example, Chapter 5 of the AICPA's Accounting Research and Terminology Bulletins, Final Edition concentrates on questions of amortization and disposes of direct charges to Surplus with one short paragraph: "Lump-sum write-offs of intangibles should not be made to earned surplus immediately after acquisition, nor should intangibles be charged against capital surplus. If not amortized systematically, intangibles should be carried at cost until an event has taken place which indicates a loss or a limitation on the useful life of the intangibles." p. 40.

[2]The Securities and Exchange Commission may have been instrumental in initiating a change of attitude in favor of amortization. The then Chief Accountant of the Commission was co-author of a chapter in Contemporary Accounting in 1945 in which the following observation is made: "The Commission has adopted no general rule as to the amortization of goodwill. However, in those cases in which a registrant has retained 'goodwill' indefinitely in its accounts, the staff has inquired into the propriety of this accounting treatment. As a result of an analysis of the nature of the account a number of registrants have undertaken programs of amortization...." William W. Werntz and Edmund B. Rickard, "Requirements of the Securities and Exchange Commission," in Contemporary Accounting, Thomas W. Leland, editor (New York: The American Institute of Accountants, 1945) Ch. 38, p. 5.

example, one of the accounting theory textbooks which was published in 1963 notes that "the amount invested in intangible assets should be carefully determined and this cost should be related to the revenues that are produced as a result of the investment."[1] A few pages later the arguments for amortization are summarized as follows:

> The amount paid for goodwill represents the purchase of an unidentifiable source of superior earning power which has a limited service life. As superior earnings emerge, it is argued, they are not income to the new owners but merely a recovery of investment. Amortization of goodwill is thus a measure of the gradual erosion of purchased "momentum."
>
> If expectations were exactly realized . . . the result of amortization would be the reporting of normal earnings during the amortization period. This squares with reality since the payment for superior earnings makes their ultimate emergence a return of capital, not income . . . . Amortizing purchased goodwill is consistent with the accounting assumption that net income is the return after the recovery of actual investment.[2]

When one remembers that the underlying structure of double entry accounting is that of a report of accountability by management, amortization of the amount invested in goodwill is logical and consistent with generally accepted principles. The purchase of these credit agencies provides a sound illustration. Since the agencies are purchased in order to obtain the revenue generated by them, the approach outlined by Meigs, Johnson and Keller results in a proper matching of revenues and costs. The older accounting concept of leaving such purchases on the books unless there is clear evidence that the goodwill has deteriorated is as extreme in one direction as is the still older procedure of writing goodwill down

---

[1]Walter B. Meigs, Charles E. Johnson and Thomas F. Keller, Intermediate Accounting (New York: McGraw-Hill Book Company, Inc., 1963) p. 606.

[2]Pages 624 and 625.

to $1 by a charge to Surplus when acquired in the other direction. The insurance regulatory system follows the latter, except that not even $1 is retained in the balance sheet, but it must be remembered that the regulatory system is primarily concerned with legal surplus as a protection to policyholders rather than with the computation of annual earnings.

Adjustments.--Adjustment 58 and 59 place the statements on the basis recommended by Meigs, Johnson and Keller. This is consistent with the Company's policy of amortization even though the assets are non-admitted.

The Financial Statements

The format of the financial statements is the same as for the companies previously discussed, so needs no specific elaboration in this section. The statements for Company D are especially important to this study, however, because they reflect the significance of the adjustments being made insofar as they permit earlier reporting of decreases in earnings from a leveling off of volume. This effect can be traced by comparing the "Net gain (loss) from operations per the Convention Blank" with the "Net income (loss) per revised earnings statement" in Exhibit II. The years 1950 and 1951 are particularly interesting because the revised earnings statements reflect dramatic drops in earnings to a loss situation whereas the Convention Blank shows only a modest drop, particularly in 1950. This is the year in which stockholders and other users of the statements should have been alerted to the trend of earnings. At the same time, it should be noted that the Convention Blank figures do show a decrease in earnings, not an increase as casual observers sometimes assume would be reflected under such circumstances.

The earnings for 1957 and 1958 are also of considerable interest. Both the Convention Blank and the revised earnings statements reflect substantial losses in 1957 during the time of rapid expansion of district offices and other activity noted in the opening paragraphs of this discussion. It is possible that the Convention Blank earnings figures were discounted to some extent in the minds of management and stockholders because of the publicity which has been given to the fact that the regulatory system results in decreased earnings when a company is expanding. However, if earnings statements which are accepted as a fair measure of actual earnings show substantial losses, most users would pay considerable heed.

One of the most significant aspects of the financial statements for Company D is the size of the earned deficit. Under the regulatory system, only one Surplus figure is shown. The accumulated deficit reached nearly $750,000 in 1959 at a time when the outstanding capital stock was a little over $300,000. The fact that this significant information was not apparent in statements based on the Convention Blank should concern stockholders and others interested in full reporting by management.

An item which does not appear in the Convention Blank financial statements themselves, but which is revealed in a question which must be answered, is that a positive surplus was possible in the Convention Blank statements only because funds were obtained through the use of surplus notes. These securities are so unusual and so peculiar to the insurance industry that they are discussed under a separate caption below.

Surplus Notes

The first reaction of a person who is not familiar with the formation of insurance companies is apt to be one of shock when he first encounters

surplus notes. However, when the reason for the use of this security is understood, that feeling tends to subside.

Primary reason for use

The primary use of surplus notes, and related securities such as guaranty certificates, and debentures, is in the formation of mutual companies. Mutual companies have no capital stock. Many states require all companies, including mutuals, to have a minimum legal surplus before they can commence business. Even if this is not required, it will ordinarily be several years before a newly formed mutual company will have sufficient earnings to cover all of the items which must be charged to expense or against surplus in the Convention Blank. Consequently, they must obtain a legal surplus from some source before they can commence business. The only way to do this is to have someone give it to them. Securities such as guaranty certificates and surplus notes permit this gift while, at the same time, providing a means whereby the gift can be returned, with interest, to the donor at a later date when the company has built an adequate surplus of its own. The original issuance of these securities is closely controlled by the state insurance department. Repayment is just as strictly regulated and can be made only when specific relationships and surplus balances have been established and then, ordinarily, only with the express permission of the state insurance department.[1]

---

[1]Wightman does not mention surplus notes but his discussion of guarantee certificates is quite revealing: "It is a practical necessity for a newly organized life company to have at the inception of its insurance operations a sufficient amount of surplus . . . . In the case of mutual company, it is quite impractical to secure such a contribution from the original policyholders. In a few instances, companies which must be temporarily regarded as of a somewhat hybrid character have been organized. While

Other uses

Some states permit both mutual and stock companies to issue surplus notes, or similar securities known by titles such as contribution certificates, for selected purposes. For example, the Nebraska statute permits issuance with the permission of the department of insurance when needed (1) to defray the reasonable expenses of organization, (2) to provide special contingency loss funds, (3) to provide additional surplus funds, (4) to make good any deficiency, and (5) in the case of certain mutuals, maintain certain required surplus balances. The state insurance department must set a maximum amount of the issue.[1]

Treatment in the Convention Blank

The statutes provide that these surplus notes are not liabilities. For example, the Nebraska statute stipulates that "Except as provided

---

fundamentally mutual in character, these companies have been sponsored by a group of 'guarantors' who in some respects resemble stockholders. These guarantors contribute to what is commonly designated a 'Guaranty Fund' upon which they are allowed a limited return out of earnings but which is generally cumulative. Such a fund is not regarded as a 'liability' in the usual sense of the word, since it can only be returned to the contributors out of future surplus earnings. In some such cases, the entire control of the management vests exclusively in the guarantors until such time as the entire amount originally contributed by them together with interest thereon at the agreed rate has been repaid, at which time the control of the management passes to the policyholders in perpetuity." p. 393.

Beardsley discusses surplus notes briefly in explaining question 6 of the General Interrogatories: "Before a mutual company has grown to a size where its surplus from retained earnings is large enough to finance additional expansion, it may be permitted by statute to make special borrowings for this purpose. Any surplus note certificates issued in this connection will be subordinate to other claims on the company and not appear as liabilities in the financial pages." p. V-5.

[1]Section 44-220, Revised Statutes of Nebraska.

herein, such notes and indebtedness shall not be a liability or claim against any of the assets of the company."[1]

The Nebraska statute provides that guaranty certificates "shall not form a part of the legal liabilities of such company or association, but all statements published by such company or association or filed with the Director of Insurance shall show the total amount of such guaranty capital certificates outstanding."[2] The section relating to surplus notes provides only that "the amount thereof outstanding, with unpaid interest, shall be stated in each annual report."[3] This could possibly mean that answering Question 6 in the Interrogatories in the middle of the blank is sufficient. In any event, no account balance for these surplus notes appears in the financial statements. The present Nebraska Insurance Department officials do, however, insist on footnote disclosure.

<u>Specific provisions of the notes issued by Company D</u>

Contributions to surplus for which a convertible surplus note was issued totaled $551,250. Three separate contributions were made over a period of about ten months during 1956 and 1957 when the rapid expansion of district offices was being made. The examiners report summarizes the terms as follows:

> The instrument bears no interest at any time. Because of the applicable Nebraska statutes, the primary amount of the note does not constitute a liability of the company until such time as repayment in whole or in part is authorized by the Company's Board of Directors. Repayment can be authorized only when the Surplus of the Company over all liabilities is double the unpaid balance of the note.

---

[1]Section 44-221.

[2]Section 44-219.07.

[3]Section 44-220.

<u>Reporting procedure demanded by "generally accepted accounting principles"</u>

In order to achieve the complete report of accountability upon which generally accepted accounting principles are based, the Surplus account should be broken down in a way which reflects the major sources of surplus which have been made available to management. Notwithstanding the fact that surplus notes carry a title which sounds like a liability, analysis of the circumstances under which they are issued and under which they may be repaid indicates that they are really a part of surplus. They should, therefore, be shown as such in a balance sheet which bears the label of "generally accepted." Footnote or parenthetical disclosure of the fact that the contribution represented by these notes may be repaid along with "interest," if any, is obviously mandatory.

It would not be difficult to show surplus notes in the type of balance sheet used in Exhibit III of this report. The Investment by Stockholders section of such a balance sheet for Company D would appear as follows at the end of 1959:

Investment by Stockholders:		
Amount paid-in for capital stock:		
Capital stock--612,112 shares at 50¢ par	$ 306,056.00	
Premium on capital stock	430,383.17	$ 736,439.17
Contributions to surplus:		
Convertible surplus note--not repayable until legal surplus is double the amount of the note. When repaid, holder may elect to take capital stock at $1.575 per share		551,250.00
Total contributions to capital		$1,287,689.17
Retained earnings (deficit):		
Appropriations for special purposes:		
For policyholder dividends in 1963	$ 9,000.00	
Mandatory securities valuation reserve	24,377.03	
Total	$ 33,377.03	
Unrestricted retained earnings (deficit)	(718,020.92)	
Total retained earnings (deficit)		(684,643.99)
<u>Total investment by stockholders</u>		$ 603,045.18
Deduct portion included in legal capital above		476,053.69
<u>Net investment in non-admitted assets</u>		$ 126,991.49

By contrast, the Convention Blank balance sheet shows the following capital section:

Capital paid up	$306,056.00
Unassigned surplus*	169,997.69
Total	$476,053.69

*Surplus note $551,250 under authority of Sec. 44-220 and 44-221 R. S. Neb. 1943 as amended.

The footnote is not provided for in the blank, but the company inserted it. The two items classed as appropriations in the extended balance sheet are shown as liabilities in the Convention Blank.

Observation regarding basic philosophy

The handling of surplus notes pinpoints certain differences between the basic philosophy of the Convention Blank and of generally accepted accounting principles. Since the Convention Blank is basically a formula for the computation of legal surplus, which in turn is the criteria which is used to make preliminary determination of the protection for policyholders, there is no need to show the surplus notes in the Convention Blank balance sheet because they are not a liability in the legal sense of constituting a claim which ranks ahead of policyholder interests. Furthermore, the state insurance department is charged with the responsibility for guarding these policyholder interests. Since surplus notes must first be approved by the department and since they are called to the attention of other insurance departments through answers to the general interrogatories on Page 17 of the blank, their existence is fully known and controlled. The regulatory scheme is founded on the concept that the policyholder cannot understand complex insurance transactions so the insurance department must watch out for him. So long as the insurance departments, both of the

home state and those states which have only the Convention Blank as a source of information, have the data necessary to guard the interests of the policyholder, the minimum requirements of regulation are met. Individual departments often do, of course, require footnote comments or other means of disclosure.

The generally accepted accounting principles approach to the financial statements is different. Concern here is with a fair report of accountability by management. Management is asked to set forth the source of all funds which have been made available to them. Since these surplus notes are one of the sources of funds, they must be shown as such. Furthermore, a huge operating deficit is a fact which management must report if it is to meet the requirement of full accountability.

Life Insurance Company D
Comparative Earnings Statement
As Revised to Conform With "Generally Accepted Accounting Principles"

Exhibit I

	1946	1947	1948	1949	1950	1951	1952	1953	1954
Revenue:									
Premiums and annuity considerations:									
Life .	$37,007.00	$105,543.07	$195,671.84	$276,200.03	$262,578.00	$272,172.36	$307,985.05	$292,827.65	$280,053.25
Accident and health	-	-	-	-	-	-	5,766.50	19,418.75	14,667.83
Consideration for supplementary contracts	-	911.64	2,583.04	7,062.60	11,410.00	13,728.38	16,134.97	16,072.32	18,612.50
Interest, rent and dividends on investments	894.66	3,371.45	6,805.97	10,914.64	16,662.00	23,817.80	32,377.84	40,600.59	38,436.62
Other operating revenue	-	281.57	51.43	-	-	-	-	-	-
Total	$37,901.66	$110,107.73	$205,112.28	$294,177.27	$290,650.00	$309,718.54	$362,264.36	$3[illegible],919.31	$351,770.20
Deduct the portion:									
Set aside as policyholder reserves:									
Increase in legal reserves	$ 3,031.42	$ 29,298.27	$ 67,225.36	$120,159.53	$170,945.00	$176,113.83	$201,745.84	$192,936.79	$194,046.31
Adjustment for expenses on increase in deferred and uncollected premiums	-	184.09	182.27	436.55	1,195.09	338.46	4,428.07	(2,365.42)	(124.32)
Returned to policyholders as dividends	-	1,689.34	5,668.16	13,154.51	23,718.00	23,024.41	19,538.27	19,535.46	25,466.78
Total portion not revenue this year	$ 3,031.42	$ 31,171.70	$ 73,075.79	$133,750.59	$195,858.09	$199,476.70	$225,712.18	$210,106.83	$219,388.77
Gross revenue	$34,870.24	$ 78,936.03	$132,036.49	$160,426.68	$ 94,791.91	$110,241.84	$136,552.18	$158,812.48	$132,381.43
Benefits and Payments on Contracts	-	-	5,213.85	4,934.00	4,070.00	14,145.21	20,432.98	50,598.43	34,270.42
Gross income	$34,870.24	$ 78,936.03	$126,822.64	$155,492.68	$ 90,721.91	$ 96,096.63	$116,119.20	$108,214.05	$ 98,111.01
Acquisition, Investment and Administrative Expense:									
Commissions	$ 5,569.34	$ 17,190.51	$ 42,123.03	$ 66,873.77	$ 77,618.85	$ 67,364.11	$ 62,858.22	$ 54,510.47	$ 32,504.44
General insurance expense	6,694.28	16,663.42	14,838.76	21,142.21	24,329.78	39,795.79	89,592.60	75,921.49	49,499.02
General investment and real estate expense	240.15	1,996.90	3,895.00	3,869.33	4,204.00	4,260.27	4,485.32	5,759.37	5,966.45
Taxes, licenses and fees (other than income tax)	199.49	814.89	1,098.00	1,403.53	3,030.00	3,414.26	5,945.96	6,630.73	5,512.77
Net reinsurance cost (recovery)	-	-	-	-	-	-	(1,801.58)	2,711.81	3,889.83
Total	$12,703.26	$ 36,665.72	$ 61,954.79	$ 93,288.84	$109,182.63	$114,834.43	$161,080.52	$145,533.87	$ 97,372.51
Net insurance income	$22,166.98	$ 42,270.31	$ 64,867.85	$ 62,203.84	$(18,460.72)	$(18,737.80)	$(44,961.32)	$(37,319.82)	$ 738.50
Capital Gains and Losses	-	-	-	2,131.19	4,123.00	-	3,428.55	-	184.00
Net income (loss) before income tax	$22,166.98	$ 42,270.31	$ 64,867.85	$ 64,335.03	$(14,337.72)	$(18,737.80)	$(41,532.77)	$(37,319.82)	$ 922.50
Federal Income Taxes	-	-	-	-	-	708.77	882.83	1,167.69	1,475.10
Net income (loss)	$22,166.98	$ 42,270.31	$ 64,867.85	$ 64,335.03	$(14,337.72)	$(19,446.57)	$(42,415.60)	$(38,487.51)	$ (552.60)
Dispositions of Income:									
Transfers to appropriated surplus	$ -	$ -	$ -	$ 4,581.67	$ 1,693.00	$ (1,517.75)	$ (697.64)	$ 39.62	$ 4,973.24
Cash dividends to stockholders	-	-	-	-	-	3,255.00	-	-	-
Total	$ -	$ -	$ -	$ 4,581.67	$ 1,693.00	$ 1,737.25	$ (697.64)	$ 39.62	$ 4,973.24
Net addition to (reduction of) unrestricted retained earnings	$22,166.98	$ 42,270.31	$ 64,867.85	$ 59,753.36	$(16,030.72)	$(21,183.82)	$(41,717.96)	$(38,527.13)	$ (5,525.84)
Adjustment When Convention Blank Changed to Accrual Basis	-	-	-	-	-	(476.88)	-	-	-
Beginning Unrestricted Retained Earnings	-	22,166.98	64,437.29	129,305.14	189,058.50	173,027.78	151,367.08	109,649.12	71,121.99
Ending Unrestricted Retained Earnings	$22,166.98	$ 64,437.29	$129,305.14	$189,058.50	$173,027.78	$151,367.08	$109,649.12	$ 71,121.99	$ 65,596.15

Life Insurance Company D
Comparative Earnings Statement
As Revised to Conform With "Generally Accepted Accounting Principles"

Exhibit I

	1955	1956	1957	1958	1959	1960	1961	1962
Revenue:								
Premiums and annuity considerations:								
Life .	$254,432.77	$283,654.31	$ 324,139.59	$ 299,766.86	$ 416,535.92	$ 697,500.72	$1,074,070.58	$1,394,276.63
Accident and health	4,399.29	50,922.39	401,715.43	569,213.70	433,862.93	527,419.35	1,391,257.43	1,661,743.53
Consideration for supplementary contracts	22,169.66	31,760.20	38,481.73	22,114.29	16,432.01	18,094.45	18,601.94	27,109.67
Interest, rent and dividends on investments	38,547.97	55,874.40	66,641.13	76,454.58	107,559.49	151,513.90	236,785.30	273,414.42
Other operating revenue	-	18,042.02	9,368.17	614.18	529.30	1,161.91	2,712.01	4,594.26
Total	$319,549.69	$440,253.32	$ 840,346.05	$ 968,163.61	$ 974,919.65	$1,395,690.33	$2,723,427.26	$3,361,138.51
Deduct the portion:								
Set aside as policyholder reserves:								
Increase in legal reserves	$188,941.72	$231,190.26	$ 257,618.49	$ 245,730.88	$ 250,310.57	$ 365,460.20	$ 309,537.00	$ 185,446.58
Adjustment for expenses on increase in deferred and uncollected premiums	71.32	2,597.34	5,907.27	(5,945.06)	4,248.01	449.73	18,085.42	5,036.83
Returned to policyholders as dividends	26,423.01	22,232.91	22,758.04	23,386.53	24,075.13	31,440.00	31,535.57	75,201.97
Total portion not revenue this year	$215,436.05	$256,020.51	$ 286,283.80	$ 263,172.35	$ 278,633.71	$ 396,749.93	$ 359,157.99	$ 265,685.38
Gross revenue	$104,113.64	$184,232.81	$ 554,062.25	$ 704,991.26	$ 696,285.94	$ 998,940.40	$2,364,269.27	$3,095,453.13
Benefits and Payments on Contracts	43,677.31	47,774.97	149,359.84	354,235.40	362,605.05	411,646.49	1,197,073.67	1,618,300.01
Gross income	$ 60,436.33	$136,457.84	$ 404,702.41	$ 350,755.86	$ 333,680.89	$ 587,293.91	$1,167,195.60	$1,477,153.12
Acquisition, Investment and Administrative Expense:								
Commissions	$ 23,471.12	$ 39,758.03	$ 182,043.01	$ 195,470.20	$ 135,649.15	$ 253,582.91	$ 580,090.91	$ 865,006.66
General insurance expense	50,110.67	189,030.32	565,324.83	382,399.41	192,715.22	166,022.50	225,874.59	236,152.55
General investment and real estate expense	5,542.29	8,165.78	10,210.99	6,069.28	6,460.23	11,774.63	12,597.62	14,410.97
Taxes, licenses and fees (other than income tax)	5,929.26	4,034.70	23,707.69	38,353.73	4,309.13	18,910.08	36,506.37	59,359.29
Net reinsurance cost (recovery)	(15,020.91)	(17,215.51)	5,841.15	16,354.75	(6,034.71)	(4,829.21)	-	-
Total	$ 70,032.43	$223,773.32	$ 787,127.67	$ 638,647.37	$ 333,099.02	$ 445,460.91	$ 855,069.49	$1,174,929.47
Net insurance income	$ (9,596.10)	$(87,315.48)	$(382,425.26)	$(287,891.51)	$ 581.87	$ 141,833.00	$ 312,126.11	$ 302,223.65
Capital Gains and Losses	4,930.53	42,088.12	-	(34,632.64)	-	(200,000.00)	(1,755.09)	(103.47)
Net income (loss) before income tax	$ (4,665.57)	$(45,227.36)	$(382,425.26)	$(322,524.15)	$ 581.87	$ (58,167.00)	$ 310,371.02	$ 302,120.18
Federal Income Taxes	640.52	2,300.32	3,918.21	-	713.16	-	-	4,000.00
Net income (loss)	$ (5,306.09)	$(47,527.68)	$(386,343.47)	$(322,524.15)	$ (131.29)	$ (58,167.00)	$ 310,371.02	$ 298,120.18
Dispositions of Income:								
Transfers to appropriated surplus	$ 3,048.86	$ (2,025.96)	$ 1,326.84	$ 10,496.76	$ 2,457.89	$ (11,640.34)	$ 5,358.00	$ 1,783.67
Cash dividends to stockholders	-	-	-	-	6,480.00	-	-	96,981.45
Total	$ 3,048.86	$ (2,025.96)	$ 1,326.84	$ 10,496.76	$ 8,937.89	$ (11,640.34)	$ 5,358.00	$ 98,765.12
Net addition to (reduction of) unrestricted retained earnings	$ (8,354.95)	$(45,501.72)	$(387,670.31)	$(333,020.91)	$ (9,069.18)	$ (46,526.66)	$ 305,013.02	$ 199,355.06
Adjustment When Convention Blank Changed to Accrual Basis	-	-	-	-	-	-	-	-
Beginning Unrestricted Retained Earnings	65,596.15	57,241.20	11,739.48	(375,930.83)	(708,951.74)	(718,020.92)	(764,547.58)	(459,534.56)
Ending Unrestricted Retained Earnings	$ 57,241.20	$ 11,739.48	$(375,930.83)	$(708,951.74)	$(718,020.92)	$ (764,547.58)	$ (459,534.56)	$ (260,179.50)

Life Insurance Company D
Reconciliation of Revised Earnings Statements
With Summaries of Operations and Surplus Account in the Convention Blank

Exhibit II

	1946	1947	1948	1949	1950	1951	1952	1953	1954
Convention Blank Figures:									
Gross income:									
Per revised earnings statement	$34,870.24	$78,936.03	$126,822.64	$155,492.68	$ 90,721.91	$ 96,096.63	$116,119.20	$108,214.05	$ 98,111.01
Charge to self for rent of home office	-	1,250.00	1,500.00	1,800.00	1,800.00	2,400.00	2,700.00	2,700.00	2,700.00
Per Convention Blank	$34,870.24	$80,186.03	$128,322.64	$157,292.68	$ 92,521.91	$ 98,496.63	$118,819.20	$110,914.05	$100,811.01
Acquisition, investment and administrative expense:									
Commissions	$27,706.68	$57,707.03	$ 89,879.00	$104,348.25	$ 38,270.00	$ 37,483.54	$ 36,760.15	$ 34,201.30	$ 24,337.47
General insurance expense	6,354.63	14,482.37	15,686.03	22,343.58	25,276.91	44,036.94	94,539.38	78,326.75	51,697.08
General investment and real estate expense	369.59	1,996.90	3,895.00	4,426.01	4,204.00	4,490.24	4,782.96	7,855.24	6,391.30
Taxes, licenses and fees (including income tax)	70.05	814.89	1,098.00	846.85	3,030.00	4,087.56	5,780.07	5,292.41	6,152.88
Net reinsurance cost (recovery)	-	-	-	-	-	-	(1,801.58)	2,711.81	3,889.83
Total expenses per Convention Blank	$34,500.95	$75,001.19	$110,558.03	$131,964.69	$ 70,780.91	$ 90,098.28	$140,060.98	$128,387.51	$ 92,468.56
Net gain (loss) from operations per the Convention Blank	$ 369.29	$ 5,184.84	$ 17,764.61	$ 25,327.99	$ 21,741.00	$ 8,398.35	$(21,241.78)	$(17,473.46)	$ 8,342.45
Items entered direct to the Surplus account:									
Capital gains and losses on assets sold	$ -	$ -	$ -	$ 2,131.19	$ 4,123.00	$ -	$ 3,428.55	$ -	$ -
Change in value of assets owned at end of year	-	(133.85)	2,583.85	(2,060.00)	(1,029.00)	(2,136.00)	(11.35)	(700.41)	4,175.34
Change in value of non-admitted and related items	-	-	-	-	(1,147.00)	(400.00)	(5,376.68)	(8,499.30)	1,331.84
Credit agency purchased	-	-	-	-	-	-	-	-	-
Total	$ -	$ (133.85)	$ 2,583.85	$ 71.19	$ 1,947.00	$ (2,536.00)	$ (1,959.48)	$ (9,199.71)	$ 5,507.18
Net per Convention Blank before items classed as "Dispositions of Income"	$ 369.29	$ 5,050.99	$ 20,348.46	$ 25,399.18	$ 23,688.00	$ 5,862.35	$(23,201.26)	$(26,673.17)	$ 13,849.63
Adjustments (See Schedule II(A) for details):									
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ -	$ -	$ -	$ -	$ -	$ 400.00	$ 5,425.95	$ 6,610.03	$ 508.16
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	-	133.85	(2,583.85)	2,060.00	1,175.75	2,136.00	(37.92)	749.68	(4,175.34)
Group III--Provide for possible losses on certain assets	-	-	-	-	-	-	-	-	-
Group IV--Defer a portion of acquisition costs to future periods	22,137.34	37,698.26	47,755.97	37,474.48	(39,348.85)	(29,880.57)	(26,098.07)	(20,309.17)	(8,166.97)
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	(339.65)	(612.79)	(652.86)	(680.50)	146.40	2,035.65	1,495.70	1,135.12	(2,568.08)
Group VI--Transfer certain losses and expenses to the proper year and correct minor errors in the Blank	-	-	.13	81.87	.98	-	-	-	-
Total adjustments	$21,797.69	$37,219.32	$ 44,519.39	$ 38,935.85	$(38,025.72)	$(25,308.92)	$(19,214.34)	$(11,814.34)	$14,[illegible]02.23)
Net income (loss) per revised earnings statement	$22,166.98	$42,270.31	$ 64,867.85	$ 64,335.03	$(14,337.72)	$(19,446.57)	$(42,415.60)	$(38,487.51)	$ (552.60)
Difference Between Net Gain From Operations per the Convention Blank and Net Income per the Revised Earnings Statement	$21,797.69	$37,085.47	$ 47,103.24	$ 39,007.04	$(36,078.72)	$(27,844.92)	$(21,173.82)	$(21,014.05)	$ (8,895.05)

Life Insurance Company D
Reconciliation of Revised Earnings Statements
With Summaries of Operations and Surplus Account in the Convention Blank

Exhibit II

	1955	1956	1957	1958	1959	1960	1961	1962
Convention Blank Figures:								
Gross income:								
Per revised earnings statement	$ 60,436.33	$ 136,457.84	$ 404,702.41	$ 350,755.86	$333,680.89	$ 587,293.91	$1,167,195.60	$1,477,153.12
Charge to self for rent of home office	2,700.00	2,025.00	-	-	-	-	-	-
Per Convention Blank	$ 63,136.33	$ 138,482.84	$ 404,702.41	$ 350,755.86	$333,680.89	$ 587,293.91	$1,167,195.60	$1,477,153.12
Acquisition, investment and administrative expense:								
Commissions	$ 15,748.34	$ 44,397.11	$ 224,222.87	$ 198,686.52	$124,376.31	$ 300,104.28	$ 680,101.23	$ 955,523.17
General insurance expense	52,309.18	228,654.66	578,137.45	356,118.59	157,054.37	167,519.20	225,958.91	238,693.65
General investment and real estate expense	6,062.65	8,249.28	12,109.40	6,069.28	6,460.23	11,774.63	12,597.62	14,617.30
Taxes, licenses and fees (including income tax)	5,620.04	6,251.52	25,727.49	38,353.73	5,022.29	18,910.08	36,506.37	63,152.96
Net reinsurance cost (recovery)	(15,020.91)	(17,215.51)	5,841.15	16,354.75	(6,034.71)	(4,829.21)	-	-
Total expenses per Convention Blank	$ 64,719.30	$ 270,337.06	$ 846,038.36	$ 615,582.87	$286,878.49	$ 493,478.98	$ 955,164.13	$1,271,987.08
Net gain (loss) from operations per the Convention Blank	$ (1,582.97)	$(131,854.22)	$(441,335.95)	$(264,827.01)	$ 46,802.40	$ 93,814.93	$ 212,031.47	$ 205,166.04
Items entered direct to the Surplus account:								
Capital gains and losses on assets sold	$ 2,109.70	$ 36,495.54	$ -	$ (39,188.89)	$ -	$ -	$ (1,755.09)	$ 103.47
Change in value of assets owned at end of year	-	-	(112.00)	4,012.00	(15,416.95)	(357,347.47)	(2,000.00)	1,915.06
Change in value of non-admitted and related items	12,944.14	(19,499.72)	(62,142.07)	51,368.48	-	-	(45,456.63)	(27,550.50)
Credit agency purchased	-	-	-	-	-	-	-	(405,500.00)
Total	$ 15,053.84	$ 16,995.82	$ (62,254.07)	$ 16,191.59	$(15,416.95)	$(357,347.47)	$ (49,211.72)	$ (431,031.97)
Net per Convention Blank before items classed as "Dispositions of Income"	$ 13,470.87	$(114,858.40)	$(503,590.02)	$(248,635.42)	$ 31,385.45	$(263,532.54)	$ 162,819.75	$ (225,865.93)
Adjustments (See Schedule II(A) for details):								
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$(12,944.14)	$ 8,901.34	$ (2,033.39)	$ (5,805.93)	$ 19,628.24	$ 135,203.47	$ 52,681.83	$ 34,007.18
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	2,820.83	3,025.0[illegible]	112.00	(4,012.00)	-	200,000.00	2,000.00	(2,122.00)
Group III--Provide for possible losses on certain assets	-	-	-	-	-	(200,000.00)	-	-
Group IV--Defer a portion of acquisition costs to future periods	(7,722.33)	43,800.20	62,971.81	(19,641.43)	(46,511.75)	47,739.43	98,025.03	90,432.45
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	(931.32)	11,604.18	56,196.13	(44,429.37)	(4,633.23)	22,422.64	(5,155.59)	401,668.48
Group VI--Transfer certain losses and expenses to the proper year and correct minor errors in the Blank	-	-	-	-	-	-	-	-
Total adjustments	$(18,776.96)	$ 67,330.72	$ 117,246.55	$ (73,888.73)	$(31,516.74)	$ 205,365.54	$ 147,551.27	$ 523,986.11
Net income (loss) per revised earnings statement	$ (5,306.09)	$ (47,527.68)	$(386,343.47)	$(322,524.15)	$ (131.29)	$ (58,167.00)	$ 310,371.02	$ 298,120.18
Difference Between Net Gain From Operations per the Convention Blank and Net Income per the Revised Earnings Statement	$ (3,723.12)	$ 84,326.54	$ 54,992.48	$ (57,697.14)	$(46,933.69)	$(151,981.93)	$ 98,339.55	$ 92,954.14

Life Insurance Company D
Exhibit II

Life Insurance Company D
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule II(A)

	1946	1947	1948	1949	1950	1951	1952	1953	1954
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):									
2. Advances to agents and officers	$ -	$ -	$ -	$ -	$ -	$ 400.00	$ 325.00	$ (725.00)	$ -
3. Loans considered inadmissible	-	-	-	-	-	-	49.27	(49.27)	-
4. Agents' debit balances	-	-	-	-	-	-	5,051.68	7,384.30	508.16
11. College plan notes	-	-	-	-	-	-	-	-	-
12. Deposit in industrial bank	-	-	-	-	-	-	-	-	-
Total Group I adjustments	$ -	$ -	$ -	$ -	$ -	$ 400.00	$ 5,425.95	$ 6,610.03	$ 508.16
Group II--Reverse revaluation of securities to N.A.I.C. values, thus returning them to amortized cost:									
20. Bonds	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
21. Stocks	-	133.85	(2,583.85)	2,060.00	1,175.75	2,136.00	(37.92)	749.68	(4,175.34)
22. Mortgage loans	-	-	-	-	-	-	-	-	-
Total Group II adjustments	$ -	$ 133.85	$(2,583.85)	$ 2,060.00	$ 1,175.75	$ 2,136.00	$ (37.92)	$ 749.68	$ (4,175.34)
Group III--Provide for possible losses on certain assets:									
31. Non-admitted current assets	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
32. Stock in other insurance companies	-	-	-	-	-	-	-	-	-
Total Group III adjustments	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Group IV--Defer a portion of acquisition costs to future periods:									
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$22,277.38	$40,516.52	$50,094.27	$39,881.20	$(36,455.95)	$(40,476.79)	$(26,098.07)	$(20,309.17)	$ (8,166.97)
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	-	-	-	-	-	-	-	-	-
44. Record accrued commissions (in years before the new form of Convention Blank was adopted)	(140.04)	(2,818.26)	(2,338.30)	(2,406.72)	(2,892.90)	10,596.22	-	-	-
Total Group IV adjustments	$22,137.34	$37,698.26	$47,755.97	$37,474.48	$(39,348.85)	$(29,880.57)	$(26,098.07)	$(20,309.17)	$ (8,166.97)
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:									
50. Record furniture and equipment as an asset	$ 190.36	$ 211.40	$ 206.11	$ 173.10	$ -	$ 2,020.50	$ 1,826.77	$ 391.20	$ -
51. Record depreciation of furniture and equipment	(19.04)	(40.18)	(60.78)	(78.10)	(78.10)	(179.35)	(462.82)	(685.94)	(501.94)
52. Reverse entry for change in net book value of furniture and equipment	-	-	-	-	-	-	-	1,840.00	(1,840.00)
55. Record depreciation on home office building	(510.97)	(784.01)	(798.19)	(775.50)	(775.50)	(805.50)	(868.25)	(910.14)	(910.14)
56. Reverse company's write down in lieu of depreciation	-	-	-	-	1,000.00	1,000.00	1,000.00	500.00	500.00
57. Change in capital gains as a result of previous adjustments in this group	-	-	-	-	-	-	-	-	184.00
58. Record cost of credit insurance agencies as an asset	-	-	-	-	-	-	-	-	-
59. Record amortization of cost of credit insurance agencies	-	-	-	-	-	-	-	-	-
Total Group V adjustments	$ (339.65)	$ (612.79)	$ (652.86)	$ (680.50)	$ 146.40	$ 2,035.65	$ 1,495.70	$ 1,135.12	$ (2,568.08)
Group VI--Transfer certain losses and expenses to the proper year and correct minor errors in the Blank:									
69. Miscellaneous minor items	$ -	$ -	$ .13	$ 81.87	$ .98	$ -	$ -	$ -	$ -
Total Effect of All Adjustments on Income	$21,797.69	$37,219.32	$44,519.39	$38,935.85	$(38,025.72)	$(25,308.92)	$(19,214.34)	$(11,814.34)	$(14,402.23)

Life Insurance Company D
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule II(A)

	1955	1956	1957	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):								
2. Advances to agents and officers	$ -	$ 2,653.00	$ 180.00	$ (2,433.00)	$ (400.00)	$ -	$ -	$ -
3. Loans considered inadmissible	-	-	-	-	-	-	-	-
4. Agents' debit balances	(12,944.14)	6,248.34	(2,213.39)	(3,437.18)	9,833.48	3,684.72	41,978.33	35,294.95
9. Returned checks and remittances	-	-	-	64.25	45.36	(109.61)	-	
11. College plan notes	-	-	-	-	10,149.40	(371.64)	(880.33)	(2,151.62)
12. Deposit in industrial bank	-	-	-	-	-	122,000.00	-	-
13. Receivable from other companies	-	-	-	-	-	10,000.00	11,583.83	863.85
Total Group I adjustments	$(12,944.14)	$ 8,901.34	$ (2,033.39)	$ (5,805.93)	$ 19,628.24	$ 135,203.47	$ 52,681.83	$ 34,007.18
Group II--Reverse revaluation of securities to N.A.I.C. values, thus returning them to amortized cost:								
20. Bonds	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
21. Stocks	2,820.83	3,025.00	112.00	(4,012.00)	-	200,000.00	-	(122.00)
22. Mortgage loans	-	-	-	-	-	-	2,000.00	(2,000.00)
Total Group II adjustments	$ 2,820.83	$ 3,025.00	$ 112.00	$ (4,012.00)	$ -	$ 200,000.00	$ 2,000.00	$ (2,122.00)
Group III--Provide for possible losses on certain assets:								
31. Non-admitted current assets	$ -	$ -	$ -	$ -	$ -	$(100,000.00)	$ -	$ -
32. Stock in other insurance companies	-	-	-	-	-	(100,000.00)	-	-
Total Group III adjustments	$ -	$ -	$ -	$ -	$ -	$(200,000.00)	$ -	$ -
Group IV--Defer a portion of acquisition costs to future periods:								
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$ (7,831.75)	$(2,494.10)	$ 12,425.11	$ 1,506.15	$ 4,464.09	$ (92.59)	$106,510.97	$ 88,563.04
41 Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	109.42	7,133.18	29,754.75	1,710.17	(15,736.93)	46,613.96	(6,500.65)	1,953.47
42. Record accrued commissions (in years before the new form of Convention Blank was adopted)	-	39,161.12	20,791.95	(22,857.75)	(35,238.91)	1,218.06	(1,985.29)	(84.06)
Total Group IV adjustments	$ (7,722.33)	$43,800.20	$ 62,971.81	$(19,641.43)	$(46,511.75)	$ 47,739.43	$ 98,025.03	$ 90,432.45
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:								
50. Record furniture and equipment as an asset	$ -	$ -	$ -	$ -	$ 2,989.90	$ 3,192.50	$ 5,218.87	$ 6,365.28
51. Record depreciation of furniture and equipment	(501.94)	(1,561.78)	(7,979.33)	(3,423.07)	(3,411.84)	(2,913.86)	(3,149.26)	(3,740.12)
52. Reverse entry for change in net book value of furniture and equipment	-	10,598.38	64,175.46	(45,562.55)	(4,211.29)	(3,856.00)	(1,225.20)	(456.68)
55. Record depreciation on home office building	(929.38)	-	-	-	-	-	-	-
56. Reverse company's write down in lieu of depreciation	500.00	-	-	-	-	-	-	-
57. Change in capital gains as a result of previous adjustments in this group	-	2,567.58	-	4,556.25	-	-	-	-
58. Record cost of credit insurance agencies as an asset	-	-	-	-	-	26,000.00	-	405,500.00
59. Record amortization of cost of credit insurance agencies	-	-	-	-	-	-	(6,000.00)	(6,000.00)
Total Group V adjustments	$ (931.32)	$11,604.18	$ 56,196.13	$(44,429.37)	$ (4,633.23)	$ 22,422.64	$ (5,155.59)	$401,668.48
Group VI--Transfer certain losses and expenses to the proper year and correct minor errors in the Blank:								
69. Miscellaneous minor items	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Effect of All Adjustments on Income	$(18,776.96)	$67,330.72	$117,246.55	$(73,888.73)	$(31,516.74)	$ 205,365.54	$147,551.27	$523,986.11

Life Insurance Company D
Balance Sheet Extended to Conform With "Generally Accepted Accounting Principles"
December 31, 1962

Exhibit III

A S S E T S

	N.A.I.C. Value		Amortized Cost
Assets Admitted As Legal Investments of Insurance Reserves:			
Revenue-producing assets:			
Bonds	$3,513,402.66		$3,513,402.66
Stocks	27,715.98		27,593.98
Mortgage loans on real estate:	1,553,782.73		
Face amount of loans		$1,566,373.29	
Less unaccumulated discounts		12,590.56	1,553,782.73
Real estate held under contract of sale	4,053.53		4,053.53
Rental real estate:	85,000.00		
Cost		$ 85,000.00	
Cumulative portion charged to depreciation expense		-	85,000.00
Policy loans	354,031.30		354,031.30
Collateral loans	95,000.00		95,000.00
Total valuation prescribed by National Association of Insurance Commissioners (N.A.I.C.)	$5,632,986.20		
Total invested in revenue-producing assets			$5,632,864.20
Operating assets--at cost adjusted for amortization and depreciation, which is also the N.A.I.C. valuation:			
Current assets (see Schedule III-A for detail)			626,247.14
Utility deposits			425.00
Total invested in admitted assets			$6,259,536.34
Operating Assets Which Do Not Qualify As Admitted Assets:			
Current assets (see Schedule III-A for detail)			$ 135,836.93
College plan notes			6,745.81
Stock in other insurance companies:			
Cost		$ 200,000.00	
Less provision for possible loss		100,000.00	100,000.00
Furniture and equipment:			
Cost		$ 37,401.16	
Cumulative portion charged to depreciation expense		19,200.25	18,200.91
Costs deferred to future periods:			
Credit agencies purchased:			
Cost		$ 431,500.00	
Cumulative portion charged to expense (amortization)		12,000.00	
Remaining cost		$ 419,500.00	
First year life insurance commissions		224,313.79	
Accident and health insurance commissions		65,036.92	
Accident and health insurance acquisition costs		1,005.12	709,855.83
Total invested in non-admitted assets			$ 970,639.48
Total invested in all assets			$7,230,175.82

L I A B I L I T I E S and I N V E S T M E N T

Portion of Premiums and Investment Income Held As Reserves:			
Aggregate policy reserves:			
On life policies and contracts:			
Total actuarial reserves		$2,695,186.00	
Deduct reserve on deferred and uncollected premiums		54,844.30	
Reserve on premiums collected		$2,640,341.70	
On accident and health policies		267,650.00	$2,907,991.70
Reserve on supplemental contracts without life contingencies			14,749.46
Policyholders' dividend accumulations			199,944.12
Premium deposit funds			8,772.81
Bonus Fund			5,332.08
Total statutory insurance reserves			$3,136,790.17
Operating Liabilities:			
Current liabilities (see Schedule III-A for detail)			559,534.85
Contract payable on purchase of credit agency			504,464.06
Total liabilities			$4,200,789.08
Legal Capital:			
Capital stock--1,946,600 shares at 50 cents par		$ 973,000.00	
Surplus--N.A.I.C. valuation of admitted assets over liabilities, capital stock and appropriations		1,050,990.90	
Total legal "policyholder surplus"		$2,023,990.90	
Appropriations of surplus (specific accounts are listed below)		34,878.36	
Totals based on N.A.I.C. valuation of admitted assets		$2,058,869.26	
Deduct unrealized increment in N.A.I.C. valuation of assets:			
N.A.I.C. valuation of revenue-producing assets	$5,632,986.20		
Amortized cost of revenue-producing assets	5,632,864.20	122.00	2,058,747.26
Total legal investment			$6,259,536.34
Investment by Stockholders:			
Amount paid-in for capital stock:			
Capital stock--1,946,600 shares at 50 cents par		$ 973,000.00	
Premium on capital stock		2,281,687.88	$3,254,687.88
Retained earnings (deficit):			
Appropriations for special purposes:			
For policyholders' dividends in 1963		$ 15,000.00	
Mandatory securities valuation reserve		19,878.36	
Total		$ 34,878.36	
Unrestricted retained earnings (deficit) per Exhibit I		(260,179.50)	
Total accumulated earnings (deficit)			(225,301.14)
Total investment by stockholders			$3,029,386.74
Deduct portion included in legal reserve capital above			2,058,747.26
Net investment, of funds provided by stockholders, in non-admitted assets			$ 970,639.48
Total liabilities and investment			$7,230,175.82

Life Insurance Company D
Working Capital
December 31, 1962

Schedule III-A

	Admitted	Non-admitted	Total
Current Assets:			
Cash and bank deposits	$454,279.00	$122,000.00	$576,279.00
Premiums in course of collection	1,461.62	-	1,461.62
Accident and health insurance premiums due	104,874.59	-	104,874.59
Accrued income receivable	60,200.07	-	60,200.07
Amounts due from other companies	5,431.86	22,447.68	27,879.54
Agents' debit balances	-	91,389.25	91,389.25
Totals	$626,247.14	$235,836.93	$862,084.07
Provision for possible losses	-	100,000.00	100,000.00
Effective amount invested-carried to Exhibit III	$626,247.14	$135,836.93	$762,084.07
Current Liabilities:			
Premiums received in advance	$ 141.37	$ -	$ 141.37
Unearned investment income	8,867.03	-	8,867.03
Accounts payable for general expenses	9,617.13	-	9,617.13
Claims in process of settlement:			
Life insurance	39,326.82	-	39,326.82
Accident and health insurance	300,466.00	-	300,466.00
Accrued expenses:			
Life and annuity commissions	49,289.00	-	49,289.00
Accident and health commissions	22,260.00	-	22,260.00
Taxes--other than income taxes	48,929.41	-	48,929.41
Federal income taxes	4,000.00	-	4,000.00
Amounts withheld or held as trustee	16,510.19	-	16,510.19
Agents' credit balances	11,073.39	-	11,073.39
Remittances not allocated	49,054.51	-	49,054.51
Totals carried to Exhibit III	$559,534.85	$ -	$559,534.85
Net Policyholder and Stockholder Funds Invested In Working Capital	$ 66,712.29	$135,836.93	$202,549.22

COMPANY E

History

Highlights

Company E is the only mutual company analyzed in this study. The analysis of this company indicates that satisfactory financial reporting techniques are essentially the same for both stock and mutual companies and that the recommendations of this study are equally applicable to both.

Company E was a stock company until 1950, at which time a mutualization plan initiated in 1941 was completed. It is a larger company than the first four companies studied, so provides a test of the significance of the adjustments in a medium sized company before moving to the large National firms. The following tabulation summarizes the size and growth of the firm by ten-year intervals:

Year	Life Insurance In Force	Premiums Written During Year	Total Insurance Reserves	Total Assets[1]
1892	$ 2,056,000	$ 49,000	$ 51,000	$ 161,000
1902	8,970,000	271,000	405,000	551,000
1912	38,022,000	1,246,000	4,167,000	5,818,000
1922	95,546,000	2,919,000	14,620,000	21,878,000
1932	146,356,000	4,119,000	27,034,000	39,726,000
1942	130,797,000	3,200,000	30,988,000	40,673,000
1952	341,203,000	7,976,000	65,404,000	75,169,000
1962	1,021,984,000	23,607,000	140,056,000	162,706,000

Underwriting and reserves

Company E issues the usual forms of ordinary life, endowment and term policies and individual annuity contracts. In 1953 it entered the accident and health field and in 1959 it began writing group life and group accident and sickness insurance.

---

[1] At N.A.I.C. valuations but including non-admitted assets through 1952. The 1962 figure is the total invested in assets as shown in Exhibit III.

Approximately 52 per cent of the life insurance reserves are valued by the net level method, and approximately another 4 per cent use a modified method under which the net level equivalent is reached at the end of the third year. Currently, a portion of new policies are valued on the Commissioners Reserve Valuation Method using the 1958 CSO table and 2 1/2% interest, modified so as to reach net level equivalents at the end of the tenth year. However, almost all of the policies valued by the net level method were issued prior to 1948. This means that, except as tempered by those policies for which reserves are modified so as to reach net level equivalents at the end of three and ten years, the portion of current annual revenue transferred to reserves at the present time is not very different from that of a concern using the Commissioners Reserve Valuation Method exclusively. The warning previously sounded regarding the possibility of over-adjustment for first-year acquisition costs and the effect of reserve methods on reportable earnings is nearly as pertinent to Company E as to the concerns already discussed. As has been repeatedly emphasized, accurate capitalization of direct first-year acquisition costs would have to be based on the portion not covered by the reduction in first-year reserve requirements under the modified preliminary term methods, rather than the arbitrary method used in this study.

Adjustments Not Previously Discussed

Adjustment 64. Reverse accruals which are really appropriations of Surplus

Company E includes the anticipated cost of items ordered during the latter part of the year but not received until the following year in liabilities in the Convention Blank under the caption "Accrued Furniture, Fixtures and Supplies." The change in this account from year to year is included in the computation of net gain from operations.

The nature and effect of this procedure can best be shown by assuming an exaggerated example and tracing its course through the accounts. Assume, therefore, that the firm ordered $1 million of furniture in December, that the furniture was received and paid for in January of the following year, and that the depreciation rate is 10 per cent. The following tabulation shows each entry and adjustment which would be made by the company. The accounts are stated in conventional general journal form, but amounts are shown as increases or decreases rather than debits and credits.

			Surplus	
	Assets	Liabilities	Gain From Operations	Direct Charge
In Year 0:				
Change in Accrued Furniture			$(1,000,000)	
Accrued Furniture		$ 1,000,000		
Adjustment given effect in the Convention Blank.				
Totals for Year 0	-0-	$ 1,000,000	$(1,000,000)	-0-
In Year 1:				
Furniture	$ 1,000,000			
Cash	(1,000,000)			
Received and paid for the furniture.				
Depreciation Expense			$ (100,000)	
Furniture	(100,000)			
Annual depreciation				
Change in Value of Non-admitted Assets				$(900,000)
Furniture	(900,000)			
Adjustment given effect in the Convention Blank.				
Accrued Furniture		$(1,000,000)		
Change in Accrued Furniture			1,000,000	
Adjustment given effect in the Convention Blank.				
Totals for Year 1	$(1,000,000)	$(1,000,000)	$ 900,000	$(900,000)
In Each Succeeding Year:				
Depreciation Expense			$ (100,000)	
Furniture	$ (100,000)			
Annual depreciation				
Furniture	100,000			
Change in Value of Non-admitted Assets				$(100,000)
Adjustment given effect in the Convention Blank.				
Totals for each succeeding year	-0-	-0-	$ (100,000)	$ 100,000

The above analysis proves that the method followed by Company E charges the entire cost of the furniture to operating expense when ordered. An income item is included in the earnings statement when the furniture is paid for. Since the gain from operations is transferred to the Surplus account, Surplus is reduced by the entire cost of the furniture when ordered, but is not affected after that. Each year, depreciation is charged as an expense in the Operating Statement, but is offset by an equal income item entered direct to Surplus. The decrease in assets in Year 1 is, of course, the expenditure of cash, the Furniture account being entered in the ledger but removed from the balance sheet by the adjustments in the Convention Blank.[1]

The rationale for Company E's procedure is easy to discern when one remembers that the Convention Blank is primarily a formula for the computation of legal surplus and that the criterion of impairment of capital is the preliminary guideline which has been adopted by the regulatory authorities. Since the firm may be committed to the expenditure for these assets as soon as they are ordered, a portion of Surplus equal to that commitment is no longer available for the protection of policyholders. So, Surplus should be reduced. The above entries do just that.

Financial statements emphasizing the double entry concept of accountability must do more than this. The huge expense in the year furniture is ordered and compensating income reflected in the operating statement the following year do not provide a fair measure of earnings. Inclusion of the liability for the expected cost of furniture without including the

---

[1]This process was previously discussed in connection with the analysis of Adjustment 52 in Chapter III.

furniture as an asset does not provide a complete report of the funds made available to management and an accounting of what was done with those funds.

Before the procedures which are in accord with generally accepted accounting principles can be determined, it is necessary to inquire into the nature of the "liability" which Company E includes in its balance sheet. It is really nothing more than a purchase commitment. This is something which should be disclosed, but there is no present liability. Disclosure can be made by means of a footnote or by setting up an Appropriation of Surplus, or Surplus Reserve. The only time a deduction should be made in the income statement is when a loss is clearly in prospect as a result of the commitment.[1] Then, the loss should be deducted in the year in which the event which caused it occurred.

Adjustment 64 transfers the "Accrued Furniture, Fixtures and Supplies" account from liabilities to Surplus Reserve and eliminates the amount of the change in this account from the Operating Statement. Legal Surplus is left unchanged, thus recognizing the soundness of the procedure for regulatory purposes and keeping the extended balance sheet in conformance with the Convention Blank.

Adjustment 65. Reverse charge to expense for Group Disaster Contingency Reserve

After 1959 this reserve, required by the State of Missouri, is treated as an appropriation of Surplus. Adjustment 65 makes the 1959 statements conform with this procedure.

---

[1]Finney and Miller, Intermediate, p. 439.

The Financial Statements

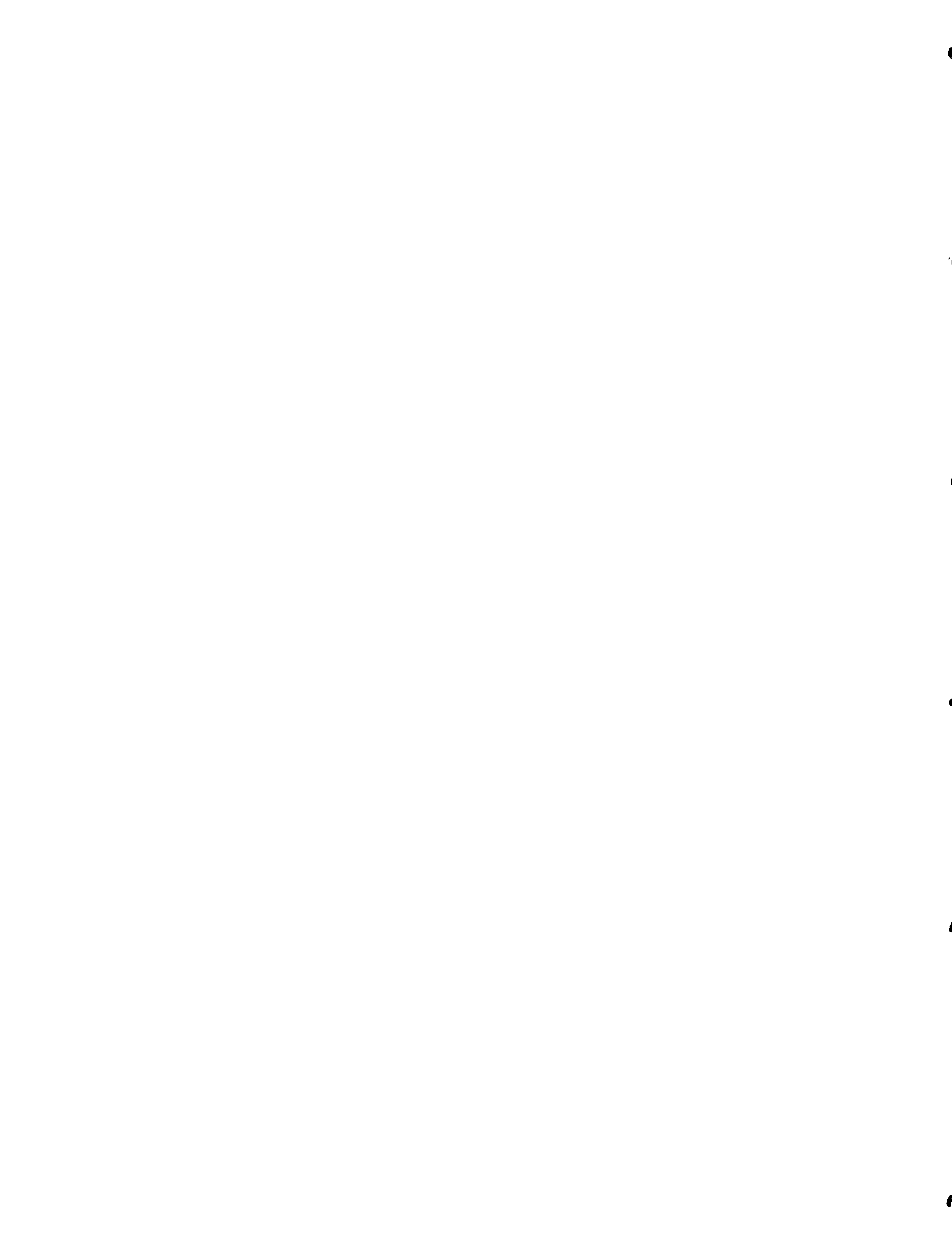
The financial statements speak for themselves. As one would expect, the rapid expansion which has taken place in recent years has resulted in the Convention Blank showing a net loss from operations. To a large extent, this has been offset by capital gains, either realized or unrealized, so that only 1962, the year in which the stock market sustained a sizeable drop, shows a loss "per the Convention Blank before items classed as 'Dispositions of Income.' " Also, as one would expect, the adjustments during this period of expansion constitute an increase in earnings each year. However, it is interesting to note that in 1962 a loss is reported in the revised earnings statement. If the admonition of over-adjustment for first-year acquisition costs is valid, this loss should be a matter of some concern to management. However, there are some other factors which must first be given consideration.

One factor is that Company E has nearly $15 million invested in property which is leased to others. The accounting method employed has been improved in recent years but is still extremely conservative. The original method used for amortization of the cost of transportation equipment is described as follows in the 1958 examiners report:

> In all cases the equipment is leased . . . with renewable options at reduced rentals at the expiration of the original lease. All taxes, insurance expenses, and maintenance and repairs are paid for by the lessee.
>
> The Company originally amortized, or depreciated, these investments . . . at a 4% rate of return even though the actual yield was higher. This resulted in a faster charge off of the asset and a deferring of a portion of the rental income. No adjustments were made by the examiners since this is a conservative method and also the Company in recent years has amortized these investments at actual yield over the period of the original lease.

Real properties have apparently always been amortized over the original term of the lease. The 1962 examiner's report states that the company "amortizes the entire cost of the land and building of each parcel during the prime term of the lease. Most leases provide various renewal options at reduced rates."

This procedure may be a bit too conservative to provide a sound report of accountability, particularly with reference to fair measurement of both present earnings and earnings which will be reported in the future. Since the entire cost of the asset, including land, is charged against revenue during the prime term of the lease, there will be no charge against revenue during the renewal period. Should the lessee not renew at the end of the prime period, Company E will still own a parcel of real estate which will almost certainly have some value. It would seem that a better measure of earnings would be obtained if a conservative, but realistic, estimate were made of the value of the property at the end of the lease period and then amortize the expected decrease in value. This is essentially the method used in standard depreciation accounting--the difference between the cost and the expected residual value is depreciated over the expected useful life of the asset to the firm. This residual value may be a substantial portion of the original cost of the asset. For example, a salesman might purchase an automobile for $4,000. If he expects to use it for two years and realize $1,800 for it at the end of that period, he would depreciate the autmobile at the rate of $1,100 a year, thus spreading the expected cost of owning the autmobile over the two-year period he expects to use it in his business.



At the very least, it would seem reasonable to amortize the cost of the building only, and to extend that amortization over both the prime and the renewal period of the lease, perhaps in proportion to the respective rentals.

No revision is made for amortization of leases in this study because sufficient data is not available in the Convention Blank for such adjustment. The deficiencies in the company's method must be kept in mind, however, in evaluating the trend of earnings shown in Exhibit I.

Another factor which must be kept in mind is that commissions are not the only acquisition cost. One of the premises behind the adjustment for first-year commissions is that the modified preliminary term reserve methods are possibly effective in spreading these other costs over the time revenue is generated by the expenditures. So, if first-year commissions are then capitalized and amortized, the final result might be reasonably accurate. Further research at the company level is required before any conclusions can be drawn as to the soundness of this premise.

The balance sheet demonstrates that the format used in this study is just as adaptable to a mutual company as a stock company. The only difference is a minor rearrangement of the capital section and the omission of the capital stock accounts.

A final reminder is in order regarding the financial statements. These statements are designed as a research tool only and should not be interpreted as recommendations for use by industry. Many technicalities would first have to be solved by research and experimentation at the company level and consideration given to important factors which are excluded from this study. If the statements were to be used in published reports to

stockholders, and/or policyholders, they would first have to be condensed and simplified. It is believed, however, that statements condensed and simplified from perfected statements prepared along the general lines suggested could be accompanied by a full certificate by a certified public accountant.

Life Insurance Company E
Comparative Earnings Statement
As Revised to Conform With "Generally Accepted Accounting Principles"

Exhibit 1

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Revenue:										
Premiums and annuity considerations:										
Life	$ 8,853,656.41	$ 9,658,658.97	$10,573,461.95	$11,454,738.55	$13,124,331.16	$15,014,275.64	$16,007,520.99	$17,493,102.83	$19,604,309.85	$21,922,012.31
Accident and health	926.16	14,769.34	43,156.15	99,681.30	157,411.88	243,484.94	367,156.81	601,977.45	1,222,728.48	1,684,536.31
Consideration for supplementary contracts	1,307,032.84	1,472,995.15	1,551,825.62	1,490,250.99	1,649,784.97	1,940,232.58	1,813,980.67	2,126,770.87	2,404,135.19	2,968,588.70
Interest, rent and dividends on investments	2,972,270.37	3,247,162.45	3,536,360.89	3,928,489.13	4,319,660.04	4,748,628.23	5,300,084.18	5,997,706.01	6,489,215.68	7,235,089.69
Other operating revenue	98,156.02	322,613.75	153,424.80	155,476.95	238,930.86	250,651.48	265,347.45	318,236.76	289,872.01	416,630.02
Total	$13,232,041.80	$14,716,199.66	$15,858,229.41	$17,128,636.92	$19,490,118.91	$22,197,272.87	$23,754,090.10	$26,537,793.92	$30,010,261.21	$34,226,857.03
Deduct the portion:										
Set aside as policyholder reserves:										
Increase in legal reserves	$ 4,986,704.48	$ 5,750,666.78	$ 6,056,032.45	$ 6,125,018.97	$ 7,132,052.14	$ 8,185,694.88	$ 7,820,870.67	$ 8,781,321.49	$10,001,523.13	$11,520,326.89
Adjustment for expenses on increase in deferred and uncollected premiums	67,300.00	42,837.34	56,262.51	53,160.86	112,084.27	107,194.56	52,279.48	49,449.73	25,502.59	5,383.36
Returned to policyholders as dividends	683,039.99	743,658.83	830,230.77	1,104,121.79	1,169,983.59	1,457,953.68	1,656,223.09	1,826,376.91	2,274,098.14	2,486,271.44
Total portion not revenue this year	$ 5,737,044.77	$ 6,537,162.95	$ 6,942,525.73	$ 7,282,301.62	$ 8,414,120.00	$ 9,750,843.12	$ 9,529,373.24	$10,657,148.13	$12,301,123.86	$14,011,981.69
Gross revenue	$ 7,494,997.03	$ 8,179,036.71	$ 8,915,703.68	$ 9,846,335.30	$11,075,998.91	$12,446,429.75	$14,224,716.86	$15,880,645.79	$17,709,137.35	$20,214,875.34
Benefits and Payments on Contracts	3,528,003.54	3,717,722.75	4,268,076.68	4,600,124.82	5,319,700.58	6,077,099.82	7,329,421.60	7,993,013.60	9,562,721.75	11,990,201.63
Gross income	$ 3,966,993.49	$ 4,461,313.96	$ 4,647,627.00	$ 5,246,210.48	$ 5,756,298.33	$ 6,369,329.93	$ 6,895,295.26	$ 7,887,632.19	$ 8,146,415.60	$ 8,224,673.71
Acquisition, Investment and Administrative Expense:										
Commissions	$ 1,235,879.64	$ 1,331,684.26	$ 1,502,503.41	$ 1,709,486.73	$ 1,951,776.57	$ 2,333,449.12	$ 2,660,200.14	$ 2,898,434.42	$ 3,357,142.83	$ 3,620,974.54
General insurance expense	1,534,673.00	1,834,769.78	2,043,265.21	2,034,014.94	2,313,738.85	2,663,985.45	2,903,640.32	3,383,182.57	3,850,891.66	4,325,640.35
General investment and real estate expense	219,501.16	236,906.00	275,186.95	336,125.10	347,845.96	337,430.05	475,636.81	553,191.64	684,199.47	741,322.37
Taxes, licenses and fees (other than income tax)	167,876.66	185,507.59	211,991.77	247,299.33	279,878.13	319,652.15	152,700.16	641,961.21	314,210.49	450,177.54
Total	$ 3,157,930.46	$ 3,588,867.63	$ 4,032,947.34	$ 4,326,926.10	$ 4,893,239.51	$ 5,654,516.77	$ 6,192,177.43	$ 7,476,769.84	$ 8,206,444.45	$ 9,138,114.80
Net insurance income (loss)	$ 809,063.03	$ 872,446.33	$ 614,679.66	$ 919,284.38	$ 863,058.82	$ 714,813.16	$ 703,117.83	$ 410,862.35	$ (60,028.85)	$ (913,441.09)
Capital Gains and Losses	84,963.93	358,967.83	574,879.77	177,384.85	1,016,023.22	461,036.38	975,074.22	1,900,090.00	1,511,439.39	505,742.40
Net income (loss) before income tax	$ 894,026.96	$ 1,231,414.16	$ 1,189,559.43	$ 1,096,669.23	$ 1,879,082.04	$ 1,175,849.54	$ 1,678,192.05	$ 2,310,952.35	$ 1,451,410.54	$ (407,698.69)
Federal Income Taxes	176,081.35	175,274.06	246,514.64	274,533.28	312,287.19	208,035.73	82,279.76	322,000.00	633,161.18	208,618.88
Net income (loss)	$ 717,945.61	$ 1,056,140.10	$ 943,044.79	$ 822,135.95	$ 1,566,794.85	$ 967,813.81	$ 1,595,912.29	$ 1,988,952.35	$ 818,249.36	$ (616,317.57)
Dispositions of Income:										
Transfers to appropriated surplus	$ 613,607.54	$ (93,185.46)	$ 536,148.45	$ 625,136.15	$ 202,491.39	$ 969,978.89	$ 423,012.15	$ 243,447.45	$ (10,143.42)	$ (915,414.34)
Reserve strengthening	11,164.00	25,147.00	678,911.00	11,223.00	20,589.00	23,393.00	21,568.00	106,158.00	-	-
Total	$ 624,771.54	$ (68,038.46)	$ 1,215,059.45	$ 636,359.15	$ 223,080.39	$ 993,371.89	$ 444,580.15	$ 349,605.45	$ (10,143.42)	$ (915,414.34)
Net addition to (reduction of) unrestricted retained earnings	$ 93,174.07	$ 1,124,178.56	$ (272,014.66)	$ 185,776.80	$ 1,343,714.46	$ (25,558.08)	$ 1,151,332.14	$ 1,639,346.90	$ 828,392.78	$ 299,096.77
Beginning Unrestricted Retained Earnings	7,834,681.26	7,927,855.33	9,052,033.89	8,780,019.23	8,965,796.03	10,309,510.49	10,283,952.41	11,435,284.55	13,074,631.45	13,903,024.23
Ending Unrestricted Retained Earnings	$ 7,927,855.33	$ 9,052,033.89	$ 8,780,019.23	$ 8,965,796.03	$10,309,510.49	$10,283,952.41	$11,435,284.55	$13,074,631.45	$13,903,024.23	$14,202,121.00

Life Insurance Company E
Reconciliation of Revised Earnings Statements
With Summaries of Operations and Surplus Account in the Convention Blank

Exhibit II

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Convention Blank Figures:										
Gross income:										
Per revised earnings statement	$3,966,993.49	$4,461,313.96	$4,647,627.00	$5,246,210.48	$5,756,298.33	$ 6,369,329.93	$ 6,895,295.26	$ 7,887,632.19	$8,146,415.60	$ 8,224,673.71
Charge to self for rent of home office	-	-	-	-	43,000.00	54,000.00	299,756.66	333,540.00	367,368.00	368,856.00
Per Convention Blank	$3,966,993.49	$4,461,313.96	$4,647,627.00	$5,246,210.48	$5,799,298.33	$ 6,423,329.93	$ 7,195,051.92	$ 8,221,172.19	$8,513,783.60	$ 8,593,529.71
Acquisition, investment and administrative expense:										
Commissions	$1,481,349.47	$1,497,385.56	$1,734,408.22	$1,874,365.61	$2,481,970.37	$ 2,950,978.33	$ 2,827,786.74	$ 3,185,724.02	$3,637,427.99	$ 3,879,243.14
General insurance expense	1,494,673.00	1,580,932.20	2,003,265.21	2,034,014.94	2,356,738.85	2,699,985.45	3,088,985.56	3,604,988.21	4,089,264.13	4,552,261.42
General investment and real estate expense	225,052.32	236,906.00	275,186.95	336,125.10	347,845.96	355,430.05	590,048.23	681,068.64	817,326.46	857,086.13
Taxes, licenses and fees (including income tax)	338,406.85	360,781.65	458,506.41	521,832.61	592,165.32	816,687.88	652,700.16	740,240.97	706,487.67	558,796.42
Items which are really appropriations of Surplus	(1,067.69)	(1,855.70)	1,733.26	(4,794.85)	2,344.19	2,417.59	1,994.55	19,174.27	(18,502.78)	(3,668.14)
Total expenses per Convention Blank	$3,538,413.95	$3,674,149.71	$4,473,100.05	$4,761,543.41	$5,781,064.69	$ 6,825,499.30	$ 7,161,515.24	$ 8,231,196.11	$9,232,003.47	$ 9,843,718.97
Net gain (loss) from operations per the Convention Blank	$ 428,579.54	$ 787,164.25	$ 174,526.95	$ 484,667.07	$ 18,233.64	$ (402,169.37)	$ 33,536.68	$ (10,023.92)	$ (718,219.87)	$(1,253,189.26)
Items entered direct to the Surplus account:										
Capital gains and losses on assets sold	$ 84,963.93	$ 358,967.83	$ 574,879.77	$ 177,384.85	$1,016,023.22	$ 461,036.38	$ 975,074.22	$ 1,900,090.00	$1,511,439.39	$ 505,742.40
Change in value of assets over book value	11,714.09	485,417.17	450,838.52	517,133.02	(444,465.33)	3,073,606.51	2,108,893.46	(1,549,564.89)	236,704.60	(1,160,391.22)
Change in value of non-admitted and related items	44,818.58	(32,227.54)	103,161.26	(11,149.25)	(102,504.36)	(271,193.35)	(105,285.90)	(19,949.27)	(82,924.95)	(8,211.30)
Other items entered direct to Surplus	-	(213,837.58)	-	-	-	-	539,000.00	(56,000.00)	(240,884.00)	(100,000.00)
Total	$ 141,496.60	$ 598,319.88	$1,128,879.55	$ 683,368.62	$ 469,053.53	$ 3,263,449.54	$ 3,517,681.78	$ 274,575.84	$1,424,335.04	$ (762,860.12)
Net per Convention Blank before items classed as dispositions of income	$ 570,076.14	$1,385,484.13	$1,303,406.50	$1,168,035.69	$ 487,287.17	$ 2,861,280.17	$ 3,551,218.46	$ 264,551.92	$ 706,115.17	$(2,016,049.38)
Adjustments (see Schedule II(A) for details):										
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ (52,862.80)	$ 23,717.65	$ (120,177.41)	$ (2,841.22)	$ 41,168.40	$ (42,891.46)	$ (14,504.37)	$ (15,974.01)	$ 31,037.55	$ 3,731.87
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	(11,714.09)	(485,417.17)	(450,838.52)	(517,133.02)	444,465.33	(3,073,606.51)	(2,108,893.46)	1,549,564.89	(236,704.60)	1,110,518.04
Group III--Provide for possible losses on certain assets	-	-	-	-	-	-	-	-	-	-
Group IV--Defer a portion of acquisition costs to future periods	245,469.83	165,701.30	231,904.81	164,878.88	530,193.80	617,529.21	167,586.60	303,432.24	284,416.62	263,221.40
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	8,044.22	8,509.89	17,016.15	13,990.47	61,335.96	314,084.81	119,790.27	35,923.28	51,887.40	25,928.64
Group VI--Transfer certain losses and expenses to the proper year and correct minor errors in the Blank	(41,067.69)	(41,855.70)	(38,266.74)	(4,794.85)	2,344.19	291,417.59	(119,285.21)	(148,545.97)	(18,502.78)	(3,668.14)
Total adjustments	$ 147,869.47	$ (329,344.03)	$ (360,361.71)	$ (345,899.74)	$1,079,507.68	$(1,893,466.36)	$(1,955,306.17)	$ 1,724,400.43	$ 112,134.19	$ 1,399,731.81
Net income (loss) per revised earnings statement	$ 717,945.61	$1,056,140.10	$ 943,044.79	$ 822,135.95	$1,566,794.85	$ 967,813.81	$ 1,595,912.29	$ 1,988,952.35	$ 818,249.36	$ (616,317.57)
Difference Between Net Gain from Operations per the Convention Blank and Net Income per the Revised Earnings Statement	$ 289,366.07	$ 268,975.85	$ 768,517.84	$ 337,468.88	$1,548,561.2[illegible]	$ 1,369,983.18	$ 1,562,375.61	$ 1,998,976.27	$1,536,469.23	$ 636,871.69

Life Insurance Company E
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule II(A)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):										
1. Supplies, stationery, printed matter	$ 9,114.14	$ 752.37	$ 16,992.30	$ (1,918.51)	$ 18,180.56	$ (17,229.81)	$ 13,629.54	$ 5,232.83	$ 4,315.99	$ (1,075.98)
4. Agents' debit balances	(59,025.93)	25,757.41	(146,394.45)	2,641.25	19,569.71	(27,921.40)	(25,862.61)	(16,050.58)	(5,554.30)	7,636.04
6. Insurance premiums paid in advance	(2,951.01)	(2,792.13)	9,224.74	(3,563.96)	3,418.13	2,259.75	(2,271.30)	(5,156.26)	12,275.86	(4,277.40)
7. Bills receivable	-	-	-	-	-	-	-	-	20,000.00	(20,000.00)
8. Foreign exchange	-	-	-	-	-	-	-	-	-	21,449.21
Total Group I adjustments	$ (52,862.80)	$ 23,717.65	$ (120,177.41)	$ (2,841.22)	$ 41,168.40	$ (42,891.46)	$ (14,504.37)	$ (15,974.01)	$ 31,037.55	$ 3,731.87
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:										
20. Bonds	$ (48,293.29)	$ (62,766.96)	$ 23,545.25	$ 41,928.00	$ 50,016.20	$ (17,414.90)	$ 31,515.10	$ 90,740.18	$ (38,077.82)	$ (15,993.51)
21. Stocks	36,579.20	(422,650.21)	(474,383.77)	(559,061.02)	394,449.13	(3,056,191.61)	(2,140,408.56)	1,458,824.71	(198,626.78)	1,126,511.55
Total Group II adjustments	$ (11,714.09)	$ (485,417.17)	$ (450,838.52)	$ (517,133.02)	$ 444,465.33	$ (3,073,606.51)	$ (2,108,893.46)	$ 1,549,564.89	$ (236,704.60)	$ 1,110,518.04
Group IV--Defer a portion of acquisition costs to future periods:										
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$ 244,745.75	$ 164,418.54	$ 226,777.30	$ 162,449.91	$ 527,872.94	$ 613,858.92	$ 169,292.43	$ 280,026.41	$ 280,237.29	$ 256,965.20
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	724.08	1,282.76	5,127.51	2,428.97	2,320.86	3,670.29	(1,705.83)	7,263.19	47.87	1,303.40
42. Accident and health insurance direct acquisition cost (deferred in the same manner as Item 41)	-	-	-	-	-	-	-	16,142.64	4,131.46	4,952.80
Total Group IV adjustments	$ 245,469.83	$ 165,701.30	$ 231,904.81	$ 164,878.88	$ 530,193.80	$ 617,529.21	$ 167,586.60	$ 303,432.24	$ 284,416.62	$ 263,221.40
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:										
52. Reverse entry for change in net book value of furniture and fixtures	$ 8,044.22	$ 8,509.89	$ 17,016.15	$ 13,990.47	$ 61,335.96	$ 314,084.81	$ 119,790.27	$ 35,923.28	$ 51,887.40	$ 25,928.64
Group VI--Transfer certain losses and expenses to the proper year and correct minor errors in the Blank:										
60. Retroactive income tax on 1958 income	$ -	$ -	$ -	$ -	$ -	$ 289,000.00	$ (121,279.76)	$ (167,720.24)	$ -	$ -
63. Past services portion of pension plan	(40,000.00)	(40,000.00)	(40,000.00)	-	-	-	-	-	-	-
64. Reverse accruals which are really appropriations of Surplus	(1,067.69)	(1,855.70)	1,733.26	(4,794.85)	2,344.19	2,417.59	1,962.39	19,174.27	(18,502.78)	(3,668.14)
65. Reverse charge to expense for Group Disaster Contingency Reserve	-	-	-	-	-	-	32.16	-	-	-
Total Group VI adjustments	$ (41,067.69)	$ (41,855.70)	$ (38,266.74)	$ (4,794.85)	$ 2,344.19	$ 291,417.59	$ (119,285.21)	$ (148,545.97)	$ (18,502.78)	$ (3,668.14)
Total Effect of All Adjustments on Income	$ 147,869.47	$ (329,344.03)	$ (360,361.71)	$ (345,899.74)	$ 1,079,507.68	$ (1,893,466.36)	$ (1,955,306.17)	$ 1,724,400.43	$ 112,134.19	$ 1,399,731.81

Life Insurance Company E
Balance Sheet Extended to Conform With "Generally Accepted Accounting Principles"
December 31, 1962

Exhibit III

ASSETS

	N.A.I.C. Value		Amortized Cost
Assets Admitted As Legal Investments of Insurance Reserves:			
Revenue-producing assets:			
Bonds	$ 75,553,792.78		$ 75,679,190.28
Stocks	12,815,015.38		8,776,692.09
Mortgage loans on real estate	33,396,957.83		33,396,957.83
Real estate leased to others	13,016,461.33		13,016,461.33
Equipment leased to others	1,819,203.66		1,819,203.66
Policy loans	14,017,957.08		14,017,957.08
Collateral loans	2,001,566.10		2,001,566.10
Adjustment for foreign exchange rates	(21,449.21)		-
Total valuation prescribed by National Association of Insurance Commissioners	$152,599,504.95		
Total invested in revenue-producing assets			$148,708,028.37
Operating assets--at cost, which is also the valuation prescribed by National Association of Insurance Commissioners:			
Current assets:			
Cash		$2,591,475.78	
Receivables		24,357.42	
Accrued investment income receivable		1,814,179.64	4,430,012.84
Home office:			
Cost		$4,130,554.60	
Cumulative portion charged to depreciation expense		270,200.00	3,860,354.60
Electronic data processing equipment:			
Cost		$ 171,011.61	
Cumulative portion charged to depreciation expense		16,425.28	154,586.33
Total invested in admitted assets			$157,152,982.14
Operating Assets Which Do Not Qualify As Admitted Assets:			
Current assets:			
Agents' debit balances:			
Total		$ 60,293.59	
Deduct provision for uncollectible accounts		7,278.05	
Net		$ 53,015.54	
Stationery, supplies and printed matter		95,816.15	
Insurance premiums paid in advance		15,777.71	164,609.40
Furniture, equipment, automobiles and airplane:			
Cost		$1,321,119.67	
Cumulative portion charged to depreciation expense		558,095.37	763,024.30
Costs deferred to future periods:			
First year life insurance commissions		$4,578,124.01	
Accident and health insurance commissions		22,463.10	
Accident and health insurance acquisition costs		25,226.90	4,625,814.01
Total invested in non-admitted assets			$ 5,553,447.71
Total invested in all assets			$162,706,429.85

LIABILITIES and INVESTMENT

Portion of Premiums and Investment Income Held As Reserves:			
Aggregate policy reserves:			
On life policies and contracts:			
Total actuarial reserves		$125,801,346.00	
Deduct reserve on deferred and uncollected premiums		3,931,449.29	
		$121,869,896.71	
On accident and health insurance policies		325,954.67	$122,195,851.38
Reserve on supplemental contracts			4,233,724.00
Policyholders' dividend accumulations			8,749,432.33
Premium deposit funds			1,873,535.00
Total statutory policyholder reserves			$137,052,542.71
Reserve for Retirement and Other Benefits for Employees and Agents			3,003,407.80
Total statutory insurance reserves			$140,055,950.51
Operating Liabilities:			
Current liabilities:			
Policy and contract claims		$ 936,509.95	
Accounts payable and accrued expenses		542,006.59	
Agents' credit balances		214,988.13	
Premiums received in advance		125,785.99	
Other current liabilities		440,823.08	2,260,113.74
Provision for apportioned policyholder dividends payable in 1963			1,221,852.00
Total liabilities			$143,537,916.25
Legal Surplus:			
Surplus appropriated for special purposes (detail is listed below)		$ 4,966,392.60	
Unassigned statutory surplus--N.A.I.C. valuation of admitted assets over liabilities and appropriations		12,540,149.87	
Total based on National Association of Insurance Commissioners (N.A.I.C.) valuation of assets		$ 17,506,542.47	
Deduct unrealized increment in N.A.I.C. valuation of assets:			
N.A.I.C. valuation of revenue-producing assets	$152,599,504.95		
Amortized cost of revenue-producing assets	148,708,028.37	3,891,476.58	13,615,065.89
Total legal investment			$157,152,982.14
Retained Earnings:			
Surplus appropriated for special purposes:			
Contingency reserve for group insurance		$ 63,405.00	
Mandatory securities valuation reserve		3,675,176.60	
Commitments for purchase of furniture and supplies		5,959.00	
Provision for policyholder dividends not yet apportioned		1,221,852.00	$ 4,966,392.60
Unrestricted retained earnings			14,202,121.00
Total retained earnings			$ 19,168,513.60
Deduct portion included in legal reserve surplus above			13,615,065.89
Total investment of retained earnings in non-admitted assets			$ 5,553,447.71
Total liabilities and investment			$162,706,429.85

COMPANY F

History

Highlights

Company F provides a detailed analysis of one of the forty largest life insurance companies in the United States, as ranked in terms of admitted assets.[1] Interestingly, no additional adjustments of significance are required over those encountered in one or more of the smaller companies.[2]

Company F was formed in 1926. Nearly two-thirds of its stock is now owned by the company with which it shares home office and other facilities. Growth is summarized by ten-year intervals in the following tabulation:

Year	Life Insurance In Force	Premiums Written During Year	Total Insurance Reserves	Total Assets[3]
1932	$ 39,300,000	$ 800,000	$ 700,000	$ 1,000,000
1942	241,000,000	6,500,000	20,800,000	23,900,000
1952	957,000,000	43,200,000	146,200,000	177,600,000
1962	2,923,300,000	61,200,000	335,500,000	410,000,000

Underwriting and reserves

Company F writes the usual types of life insurance. Over 40 per cent of the life insurance in force is group insurance. As can be seen in Exhibit I, accident and health insurance dropped from nearly a third of premium revenue in 1953 to approximately 3 per cent in 1956, then increased to almost 10 per cent in 1962. Since June 1, 1955, all new accident and health issues have been reinsured.

---

[1] In 1962 the company was the sixteenth largest stock life insurance company in terms of admitted assets. It should be remembered, however, that the ranking would be different in terms of premiums written or insurance in force. Companies with sizeable portions of health and accident and term insurance would rank higher under these criteria.

[2] The one new adjustment (number 14) reflects an item of accounting procedure and is not a major item or new concept.

[3] At N.A.I.C. valuations but including non-admitted assets through 1952. The 1962 figure is the total invested assets as shown in Exhibit III.

Reserves are computed almost entirely on the net level premium plan, with interest mainly at 2 1/2% and 3%. This means that a higher portion of premiums are transferred to reserves and thus not considered current revenue during the first years of a policy than in the firms studied so far. This, in turn, means that the possibility of over-adjustment in the deferral of first-year life insurance commissions is, therefore, remote, except as affected by the large portion of group business. There are not enough data in the Convention Blank to permit evaluation of the effect of a large portion of group business on the validity of the adjustment for first-year life insurance commissions. It should be remembered, however, that the five-year period being used is a shorter period than would be indicated for individual life insurance alone.

Adjustments not Previously Discussed

Adjustment 14 is the only one which has not already been necessary, and therefore been discussed, in connection with the analysis of one of the first five companies studied. This adjustment reinstates premiums in the course of collection to the balance sheet. It is a valid asset from the double entry accountability point of view even though it is not admissible as a legal investment of insurance reserves.

The Financial Statements

There are only a few factors pertaining to the financial statements which have not been previously discussed in connection with the analysis of one of the first five companies studied. By and large, the items which were significant in the smaller companies are significant for Company F, and no new major factors were uncovered in the analysis of this large firm.

Earnings Statements

Since Company F has invested over $30 million in corporate stocks, the unrealized capital gains[1] and the transfers to the Mandatory Securities Valuation Reserve[2] should be carefully noted before an over-all evaluation of the statements is made.

The "Reserve Strengthening" item included in the disposition of income section of Exhibit I reflects an extra transfer to reserves. Strengthening usually involves changing the reserve calculation to a lower assumed rate of interest or changing from a modified preliminary term reserve method to the net level premium method or a method closer to net level. Life insurance companies were permitted to elect the level premium method for Federal income tax by the 1959 Revenue Act whether or not they use it for other purposes. Some companies chose to change to net level for all purposes, however.

The 1961 examination report on Company F points out that except for a small number of policies on a miscellaneous premium paying or benefit basis, the policies which were issued prior to 1959 and were previously valued on a modified basis were revalued on the net level basis at December 31, 1959. Policies issued in 1959 were valued on the net level basis. Policies issued in 1960 and subsequent years have been valued on a modified or net level basis consistent with the valuations previous to December 31, 1959.

---

[1]Shown as "Change in value of assets owned at end of year" in Exhibit II and reversed in Adjustment 21 (Exhibit II(A)).

[2]The primary item included in "Transfers to Appropriated Surplus" in Exhibit I.

The 1959 charge to surplus for the revaluation, or strengthening, again raises the question of the desirability of the current operating concept for life insurance companies. Since the earnings of life insurance companies do not fit into an annual cycle, it seems appropriate to regard earnings as the measured flow of net revenue into retained earnings during each annual period rather than as a precise measure of specific activity.

It seems, therefore, that the charge for reserve strengthening should be made in the earnings statements rather than direct to surplus. This is particularly true when the "strengthened reserves" result in materially lower transfers to reserves in future years. Where the charge to earnings is so large as to result in a material distortion of earnings in one year, an allocation over several years similar to the way the past services portion of pension plans is handled in Adjustment 63 might be appropriate.

No adjustment is made for the reserve strengthening charge to surplus in this study because sufficient data are not available in the Convention Blank for accurate allocation. The reason for the strengthening varies so much from company to company that no realistic arbitrary adjustment, such as is made for goodwill and past service portion of pension plans, is feasible. In practice, ample data should be available from the actuarial computations already made.

In many firms the "strengthening" item is relatively immaterial, but such is not the case for Company F. One of the items which is tested in the next chapter is the materiality of this item in the largest national companies.

Balance sheet

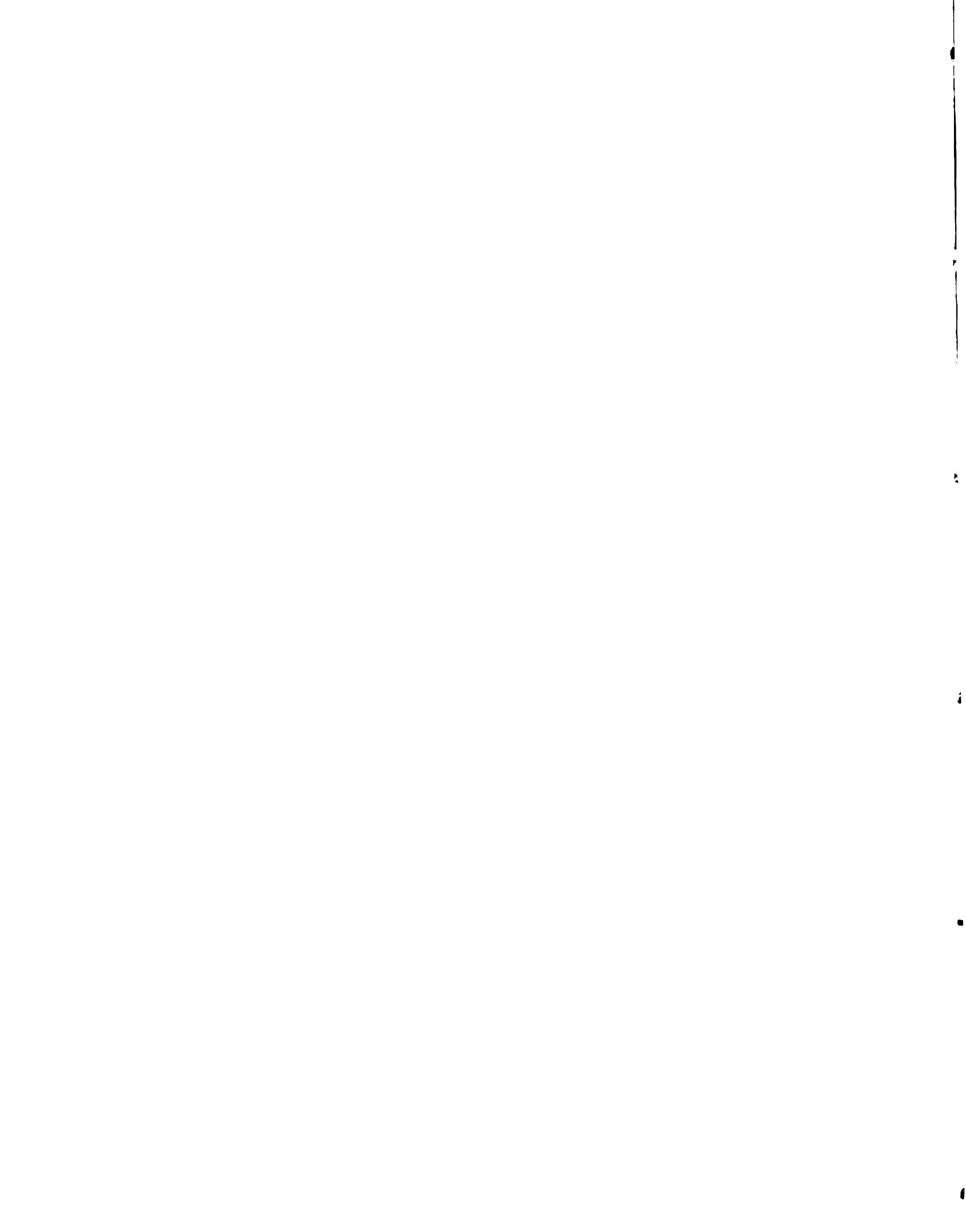
One item in the balance sheet requires an explanatory comment. The $800,000 shown as the cost of electronic data processing equipment is an

arbitrary amount. The net book value is accurate, but an arbitrary division of cost and accumulated depreciation had to be made between the electronic data processing equipment account and the furniture and equipment account.

Life Insurance Company F
Comparative Earnings Statement
As Revised to Conform With "Generally Accepted Accounting Principles"

Exhibit I

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Revenue:										
Premiums and annuity considerations:										
Life	$30,752,608.78	$34,246,779.24	$37,520,243.34	$39,742,582.81	$41,481,036.59	$43,825,453.85	$45,509,153.94	$47,792,735.03	$51,566,100.81	$55,293,067.70
Accident and health	15,054,868.37	14,785,312.83	6,892,845.85	1,307,244.95	4,998,943.45	8,358,541.47	7,528,783.00	6,795,498.00	6,214,939.24	5,871,268.24
Consideration for supplementary contracts	1,065,421.96	715,014.73	1,190,800.78	1,063,937.86	1,296,870.27	1,133,884.59	1,290,800.93	1,245,215.24	1,376,687.79	1,084,450.03
Interest, rent and dividends on investments	7,246,524.76	8,111,310.75	8,734,709.01	9,900,021.14	11,023,136.18	12,388,146.16	13,593,675.05	15,057,292.24	16,570,843.21	18,289,557.26
Other operating revenue	-	6,666.46	247,874.88	8,148.68	1,672.67	2,980.01	5,835.50	6,719.07	21,086.64	84,376.30
Total	$54,119,423.87	$57,865,084.01	$54,586,473.86	$52,021,935.44	$58,801,659.16	$65,709,006.08	$67,928,248.42	$70,897,459.58	$75,749,657.69	$80,622,719.53
Deduct the portion:										
Set aside as policyholder reserves:										
Increase in legal reserves	$15,787,041.33	$16,784,120.58	$17,123,533.59	$18,132,011.59	$18,193,773.67	$19,246,540.89	$21,855,434.47	$17,999,781.86	$19,102,679.69	$20,518,499.44
Adjustment for expenses on increase in deferred and uncollected premiums	112,271.62	316,538.46	260,459.56	180,158.64	73,097.68	(218,806.65)	(57,834.72)	557,509.00	126,452.17	(69,473.90)
Returned to policyholders as dividends	209.28	350.39	699.69	544.70	565.31	1,033.21	692.37	798.06	14,211.90	33,127.20
Total portion not revenue this year	$15,899,522.23	$17,101,009.43	$17,384,692.84	$18,312,714.93	$18,267,436.66	$19,028,767.45	$21,798,292.12	$18,558,088.92	$19,243,343.76	$20,482,152.74
Gross revenue	$38,219,901.64	$40,764,074.58	$37,201,781.02	$33,709,220.51	$40,534,222.50	$46,680,238.63	$46,129,956.30	$52,339,370.66	$56,506,313.93	$60,140,566.79
Benefits and Payments on Contracts	18,293,537.16	20,260,456.57	17,726,586.44	14,770,162.00	21,159,113.47	24,280,626.62	25,159,223.06	28,029,642.09	30,026,705.20	32,131,223.27
Gross income	$19,926,364.48	$20,503,618.01	$19,475,194.58	$18,939,058.51	$19,375,109.03	$22,399,612.01	$20,970,733.24	$24,309,728.57	$26,479,608.73	$28,009,343.52
Acquisition, Investment and Administrative Expense:										
Commissions	$ 7,287,461.64	$ 7,160,083.82	$ 6,259,335.31	$ 5,794,482.12	$ 6,357,200.44	$ 7,537,923.17	$ 7,230,591.12	$ 7,107,885.42	$ 7,264,308.02	$ 7,451,109.42
General insurance expense	4,881,172.08	5,320,420.60	4,708,985.05	4,184,516.88	5,090,514.35	5,551,519.28	5,603,718.38	6,161,332.55	7,137,554.03	7,237,199.44
General investment and real estate expense	1,359,097.09	1,359,440.03	1,225,125.66	1,317,722.07	1,331,674.43	1,779,586.45	1,806,426.12	1,876,222.96	1,961,655.85	2,073,981.56
Taxes, licenses and fees (other than income tax)	1,116,423.86	1,205,276.81	1,366,486.86	984,251.51	1,053,771.43	1,282,234.73	1,424,762.26	1,392,113.58	1,626,601.29	1,513,844.52
Total	$14,644,154.67	$15,045,221.26	$13,559,932.88	$12,280,972.58	$13,833,160.65	$16,151,263.63	$16,065,497.88	$16,537,554.51	$17,990,119.19	$18,276,134.94
Net insurance income	$ 5,282,209.81	$ 5,458,396.75	$ 5,915,261.70	$ 6,658,085.93	$ 5,541,948.38	$ 6,248,348.38	$ 4,905,235.36	$ 7,772,174.06	$ 8,489,489.54	$ 9,733,208.58
Adjustment of Prior Years' Expenses	-	-	-	-	-	-	-	-	-	132,176.82
Capital Gains and Losses	20,161.20	159,254.66	117,456.10	38,205.83	29,121.64	55,145.01	(523,479.30)	65,210.83	78,128.92	94,838.34
Net income (loss) before income tax	$ 5,302,371.01	$ 5,617,651.41	$ 6,032,717.80	$ 6,696,291.76	$ 5,571,070.02	$ 6,303,493.39	$ 4,381,756.06	$ 7,837,384.89	$ 8,567,618.46	$ 9,960,223.74
Federal Income Taxes	414,131.23	451,103.59	582,673.40	632,143.35	682,027.52	1,385,129.63	1,810,071.74	1,330,446.22	1,267,509.40	1,663,480.37
Net income (loss)	$ 4,888,239.78	$ 5,166,547.82	$ 5,450,044.40	$ 6,064,148.41	$ 4,889,042.50	$ 4,918,363.76	$ 2,571,684.32	$ 6,506,938.67	$ 7,300,109.06	$ 8,296,743.37
Dispositions of Income:										
Transfers to appropriated surplus	$ (943,479.11)	$ 2,567,610.25	$ 1,646,821.13	$ (557,690.00)	$ (291,270.35)	$ 118,639.00	$ 537,799.40	$ 1,453,306.67	$ 4,264,122.83	$ (677,310.28)
Reserve strengthening	-	-	-	-	-	2,670,961.65	11,869,157.00	81,489.00	68,340.00	311,426.00
Dividends to stockholders	500,000.00	500,000.00	500,000.00	500,000.00	500,000.00	500,000.00	500,000.00	500,000.00	500,000.00	500,000.00
Total	$ (443,479.11)	$ 3,067,610.25	$ 2,146,821.13	$ (57,690.00)	$ 208,729.65	$ 3,289,600.65	$12,906,956.40	$ 2,034,795.67	$ 4,832,462.83	$ 134,115.72
Net addition to (reduction of) unrestricted retained earnings	$ 5,331,718.89	$ 2,098,937.57	$ 3,303,223.27	$ 6,121,838.41	$ 4,680,312.85	$ 1,628,763.11	$(10,335,272.08)	$ 4,472,143.00	$ 2,467,646.23	$ 8,162,627.65
Beginning Unrestricted Retained Earnings	23,485,117.26	28,816,836.15	30,915,773.72	34,218,996.99	40,340,835.40	45,021,148.25	46,649,911.36	36,314,639.28	40,786,782.28	43,254,428.51
Ending Unrestricted Retained Earnings	$28,816,836.15	$30,915,773.72	$34,218,996.99	$40,340,835.40	$45,021,148.25	$46,649,911.36	$36,314,639.28	$40,786,782.28	$43,254,428.51	$51,417,056.16



Life Insurance Company F
Reconciliation of Revised Earnings Statements
With Summaries of Operations and Surplus Account in the Convention Blank

Exhibit II

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Convention Blank Figures:										
Gross income:										
Per revised earnings statement	$19,926,364.48	$20,503,618.01	$19,475,194.58	$18,939,058.51	$19,375,109.03	$22,399,612.01	$20,970,733.24	$24,309,728.57	$26,479,608.73	$28,009,343.52
Acquisition, investment and administrative expense:										
Commissions	$ 7,504,165.51	$ 7,780,605.49	$ 6,663,944.29	$ 6,634,966.97	$ 7,013,862.66	$ 7,439,439.30	$ 6,794,470.68	$ 7,238,614.30	$ 8,060,895.70	$ 8,000,253.90
General insurance expense	4,864,584.02	5,302,138.21	4,608,624.57	4,147,022.29	5,092,985.19	5,551,799.29	5,602,628.51	6,168,475.12	7,137,062.47	7,197,454.32
General investment and real estate expense	1,359,097.09	1,359,440.03	1,225,125.66	1,315,844.93	1,337,789.73	2,667,364.36	1,806,426.12	1,876,222.96	1,961,655.85	2,073,981.56
Taxes, licenses and fees (including income tax)	1,530,555.09	1,656,380.40	1,949,160.26	1,616,394.86	1,735,798.95	1,783,135.85	3,234,834.00	2,722,559.80	2,894,110.69	3,177,324.89
Items requiring reclassification to capital gains	(23,957.95)	(11,175.28)	(215.83)	(3,592.58)	-	-	(25,586.20)	(10,197.94)	8,120.59	9,708.21
Total expenses per the Convention Blank	$15,234,443.76	$16,087,388.85	$14,446,638.95	$13,710,636.47	$15,180,436.53	$17,441,738.80	$17,412,773.11	$17,995,674.24	$20,061,845.30	$20,458,722.88
Net gain (loss) from operations per the Convention Blank	$ 4,691,920.72	$ 4,416,229.16	$ 5,028,555.63	$ 5,228,422.04	$ 4,194,672.50	$ 4,957,873.21	$ 3,557,960.13	$ 6,314,054.33	$ 6,417,763.43	$ 7,550,620.64
Items entered direct to the Surplus account:										
Capital gains and losses on securities sold	$ -	$ 159,254.66	$ 117,456.10	$ 38,205.83	$ 29,121.64	$ 55,145.01	$ (523,479.30)	$ 65,210.83	$ 78,128.92	$ 94,838.34
Change in value of assets owned at end of year	(320,956.96)	2,187,775.71	1,242,637.47	(945,152.02)	(689,784.39)	4,144,577.83	1,429,549.80	836,381.68	5,358,188.50	(1,251,927.56)
Change in value of non-admitted and related items	1,635.29	2,608.72	(24,293.24)	(109,588.68)	(23,222.03)	(121,086.61)	38,856.25	(108,838.45)	(79,842.73)	(183,296.64)
Corrections and balancing items	(3,922.32)	(9,115.99)	(796.65)	(5,469.72)	6,115.30	3,549.40	(25,586.20)	(2,930.67)	8,120.59	(258,114.97)
Total	$ (323,243.99)	$ 2,340,523.10	$ 1,335,003.68	$(1,022,004.59)	$ (677,769.48)	$ 4,082,185.63	$ 919,340.55	$ 789,823.39	$ 5,364,595.28	$(1,598,500.83)
Net per Convention Blank before items classed as dispositions of income	$ 4,368,676.73	$ 6,756,752.26	$ 6,363,559.31	$ 4,206,417.45	$ 3,516,903.02	$ 9,040,058.84	$ 4,477,300.68	$ 7,103,877.72	$11,782,358.71	$ 5,952,119.81
Adjustments (see Schedule II(A) for details)										
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 6,499.52	$ 8,515.90	$ 63,420.17	$ (11,803.91)	$ 25,134.67	$ (11,422.38)	$ (91,616.80)	$ 78,862.35	$ 106,624.13	$ 409,410.06
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	323,232.96	(2,175,661.97)	(1,269,178.91)	1,026,559.08	637,724.05	(4,105,380.78)	(1,391,505.53)	(936,830.48)	(5,457,274.96)	852,875.37
Group IV--Defer a portion of acquisition costs to future periods	200,241.38	600,179.99	304,829.32	802,990.26	659,133.06	(98,203.86)	(437,210.31)	130,604.18	796,096.12	909,399.36
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	(10,410.81)	(23,238.36)	(12,585.49)	39,985.53	50,147.70	93,311.94	14,716.28	130,424.90	72,305.06	172,938.77
Group VI--Transfer certain losses and expenses to the proper year and correct minor errors in the Blank	-	-	-	-	-	-	-	-	-	-
Total adjustments	$ 519,563.05	$(1,590,204.44)	$ (913,514.91)	$ 1,857,730.96	$ 1,372,139.48	$(4,121,695.08)	$(1,905,616.36)	$ (596,939.05)	$(4,482,249.65)	$ 2,344,623.56
Net income (loss) per revised earnings statement	$ 4,888,239.78	$ 5,166,547.82	$ 5,450,044.40	$ 6,064,148.41	$ 4,889,042.50	$ 4,918,363.76	$ 2,571,684.32	$ 6,506,938.67	$ 7,300,109.06	$ 8,296,743.37
Difference Between Net Gain From Operations per the Convention Blank and Net Income per the Revised Earnings Statement	$ 196,319.06	$ 750,318.66	$ 421,488.77	$ 835,726.37	$ 694,370.00	$ (39,509.45)	$ (986,275.81)	$ 192,884.34	$ 882,345.63	$ 746,122.73

Life Insurance Company F
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule II(A)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):										
2. Advances to agents or officers	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3. Loans considered inadmissible	-	-	-	-	-	-	-	-	-	8,953.08
4. Agents' debit balances	7,081.97	17,805.97	39,984.71	66,611.78	(29,202.20)	28,302.62	(54,390.59)	(20,478.87)	(5,009.38)	(11,160.77)
5. Premium notes, etc., in excess of net value of individual policies	-	(500.00)	-	-	-	-	-	-	-	-
7. Bills receivable	1,693.55	2,823.67	(3,105.98)	2,991.37	2,276.53	(527.95)	818.06	(1,107.58)	12,547.05	(3,724.49)
8. Foreign exchange	(2,276.00)	(11,613.74)	26,541.44	(81,407.06)	52,060.34	(39,197.05)	(38,044.27)	100,448.80	99,086.46	399,052.19
14. Premiums in course of collection	-	-	-	-	-	-	-	-	-	16,290.05
Total Group I adjustments	$ 6,499.52	$ 8,515.90	$ 63,420.17	$ (11,803.91)	$ 25,134.67	$ (11,422.38)	$ (91,616.80)	$ 78,862.35	$ 106,624.13	$ 409,410.06
Group II--Reverse revaluation of securities to N.A.I.C. values, thus returning them to amortized cost:										
20. Bonds	$ (220.36)	$ 9,772.53	$ 5,590.97	$ 85,174.40	$ (41,327.51)	$ (11,588.52)	$ 86,151.24	$ (29,116.78)	$ (22,500.00)	$ (353,813.31)
21. Stocks	323,453.32	(2,185,434.50)	(1,274,769.88)	941,384.68	679,051.56	(4,093,792.26)	(1,477,656.77)	(907,713.70)	(5,434,774.96)	1,206,688.68
Total Group II adjustments	$ 323,232.96	$ (2,175,661.97)	$ (1,269,178.91)	$ 1,026,559.08	$ 637,724.05	$ (4,105,380.78)	$ (1,391,505.53)	$ (936,830.48)	$ (5,457,274.96)	$ 852,875.37
Group IV--Defer a portion of acquisition costs to future periods:										
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$ 395,598.80	$ 656,121.36	$ 872,338.35	$ 989,539.47	$ 298,540.33	$ (35,744.82)	$ (389,006.16)	$ 152,868.47	$ 834,903.00	$ 565,673.72
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	(178,894.93)	(35,599.69)	(467,729.37)	(149,054.62)	358,121.89	(62,739.05)	(47,114.28)	(22,139.59)	(38,315.32)	(16,528.74)
42. Accident and health insurance direct acquisition costs (deferred in same manner as Item 41)	(16,462.49)	(20,341.68)	(99,779.66)	(37,494.59)	2,470.84	280.01	(1,089.87)	(124.70)	(491.56)	254.38
Total Group IV adjustments	$ 200,241.38	$ 600,179.99	$ 304,829.32	$ 802,990.26	$ 659,133.06	$ (98,203.86)	$ (437,210.31)	$ 130,604.18	$ 796,096.12	$ 909,399.36
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:										
52. Reverse entry for change in net book value of furniture and equipment	$ (10,410.81)	$ (23,238.36)	$ (12,585.49)	$ 39,985.53	$ 50,147.70	$ 93,311.94	$ 14,716.28	$ 130,424.90	$ 72,305.06	$ 172,938.77
Group VI--Transfer certain losses and expenses to the proper year and correct minor errors in the Blank:										
63. Past services portion of pension plan	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 400,000.00
Total Effect of All Adjustments on Income	$ 519,563.05	$ (1,590,204.44)	$ (913,514.91)	$ 1,857,730.96	$ 1,372,139.48	$ (4,121,695.08)	$ (1,905,616.36)	$ (596,939.05)	$ (4,482,249.65)	$ 2,384,623.56

Life Insurance Company F
Balance Sheet Extended to Conform With "Generally Accepted Accounting Principles"
December 31, 1962

Exhibit III

ASSETS

	N.A.I.C. Value		Amortized Cost
Assets Admitted As Legal Investments of Insurance Reserves:			
Revenue-producing assets:			
Bonds	$223,717,608.28		$223,451,294.97
Stocks	43,911,558.38		30,286,871.74
Mortgage loans on real estate	100,164,430.86		100,164,430.86
Real estate:	13,289,057.33		
Cost		$20,233,519.00	
Cumulative portion charged to depreciation		6,944,461.67	13,289,057.33
Policy loans	26,060,528.87		26,060,528.87
Guaranteed premium notes and interest	1,296.17		1,296.17
Adjustment for foreign exchange rates	(490,060.57)		-
Total valuation prescribed by National Association of Insurance Commissioners	$406,654,419.32		
Total invested in revenue-producing assets			$393,253,479.94
Operating assets--at cost, which is also the valuation prescribed by National Association of Insurance Commissioners:			
Current assets:			
Cash		$ 2,672,938.40	
Managers' annuity account		1,099.33	
Receivables		2,957,937.36	5,631,975.09
Electronic data processing equipment:			
Cost		$ 800,000.00	
Cumulative portion charged to depreciation expense		398,478.28	401,521.72
Separate account business			189,330.54
Total invested in admitted assets			$399,476,307.29
Operating Assets Which Do Not Qualify As Admitted Assets:			
Current assets:			
Agents' debit balances		$ 171,914.[illegible]	
Bills receivable		17,625.00	
Traveling expense advances		8,953.08	
Premiums in course of collection		16,290.05	$ 214,782.71
Furniture and equipment:			
Cost		$ 1,636,188.31	
Cumulative portion charged to depreciation expense		784,625.38	851,562.93
Costs deferred to future periods:			
First year life insurance commissions		$ 8,873,979.72	
Accident and health insurance commissions		178,480.03	
Accident and health insurance direct acquisition costs		1,299.60	
Employee retirement plan		360,000.00	9,413,759.35
Total invested in non-admitted assets			$ 10,480,104.99
Total invested in all assets			$409,956,412.28

LIABILITIES and INVESTMENT

Portion of Premiums and Investment Income Held As Reserves:			
Aggregate poli[illegible] reserves:			
On life policies and contracts:			
Total actuarial reserves		$331,663,109.00	
Deduct reserve on deferred and uncollected premiums		11,037,845.06	
Reserve on premiums collected		$320,625,263.94	
On accident and health policies		6,008,603.05	$326,633,866.99
Reserve on supplemental contracts without life contingencies			4,335,599.00
Policyholders' dividend and other accumulations			185,049.45
Premium deposit funds			1,066,417.83
Other policyholder reserves			2,871,693.89
Total statutory policyholder reserves			$335,092,626.16
Reserve for Revision of Employee Retirement Plans			400,000.00
Total statutory insurance reserves			$335,492,627.16
Current Operating Liabilities:			
Notes payable		$ 122,500.00	
Policy and contract claims		3,825,870.78	
Accounts payable and accrued expenses		3,254,435.96	
Agents' credit balances		334,923.75	
Other regular current operating liabilities		1,347,443.45	
Provision for apportioned policyholder dividends payable in 1963		2,375.93	8,887,549.87
Total liabilities			$344,380,177.03
Legal Reserve Capital:			
Capital stock--100,000 shares at $10 par		$ 1,000,000.00	
Surplus--N.A.I.C. valuation of admitted assets over liabilities, capital stock and appropriations		54,637,890.55	
Total legal "policyholder surplus"		$ 55,637,890.55	
Appropriations of Surplus (specific accounts are listed below)		12,859,179.09	
Totals based on N.A.I.C. valuation of admitted assets		$ 68,497,069.64	
Deduct unrealized increment in N.A.I.C. valuation of assets:			
N.A.I.C. valuation of revenue-producing assets	$406,654,419.32		
Amortized cost of revenue-producing assets	393,253,479.94	13,400,939.38	55,096,130.26
Total legal investment			$399,476,307.29
Investment by Stockholders:			
Amount paid-in for capital stock:			
Capital stock--100,000 shares at $10 par		$ 1,000,000.00	
Premium on capital stock		300,000.00	$ 1,300,000.00
Retained earnings:			
Appropriations for special purposes:			
Mandatory securities valuation reserve		$ 11,911,007.05	
Group contingency reserve		664,188.39	
Undistributed funds--Home Office Employees Group Insurance		261,488.27	
Provision for policyholders' dividends not yet apportioned		22,495.38	
		$ 12,859,179.09	
Unrestricted retained earnings--per Exhibit I		51,417,056.16	64,276,235.25
Total investment by stockholders			$ 65,576,235.25
Deduct portion included in legal reserve capital above			55,096,130.26
Total investment of funds provided by stockholders in non-admitted assets			$ 10,480,104.99
Total investment and liabilities			$409,956,412.28

SUMMARY

Six companies were analyzed in detail in this chapter. This analysis required the preparation of detailed annual worksheets and the preparation of revised and extended financial statements. The adjustments which are made are either (1) those which are possible using only the data in the Convention Blank or (2) arbitrary computations of factors which the companies should be able to make accurately and without serious difficulty with the information at their disposal.

The primary purpose of this detailed analysis is to obtain a thorough understanding of the Convention Blank. No other research technique can provide as deep understanding of life insurance accounting and reporting. Furthermore, the attempt to extend and revise the statements in the blank is similar to the laboratory approach of the sciences.

The revised and extended statements are admittedly imperfect in technical detail, but serve as an effective research tool. They are too complex for public usage in present form, but, with the exception of factors which had to be specifically excluded from this study because additional research would first have to be conducted at the company level, provide an acceptable report of accountability which conforms with generally accepted accounting principles on material items while retaining the computation of legal surplus inherent in the Convention Blank statements. It is believed that, if technical details can be solved at the company level, simplified statements prepared within the framework suggested could be included in annual statements to stockholders and be accompanied by a full, or clean, certificate by a certified public accountant.

The six firms analyzed range from small companies organized since World War II to a company which is one of the forty largest life insurance

companies and one of the twenty largest stock companies in the United States. Six companies do not provide a sufficient sample to establish the materiality of the adjustments and the degree of improvement in the revised statements, but are sufficient to verify the technique of adjustment and the methods followed in obtaining data for the adjustments. It is particularly noteworthy that all of the major adjustments were required in one or more of the small companies and that no additional types were needed in Company F. The laborious and time consuming worksheet and financial statement proofs are, therefore, omitted in the analyses in the next chapter, in order to concentrate on the materiality of the adjustments and revisions.

CHAPTER V

MATERIALITY OF THE ADJUSTMENTS FOR A WIDE RANGE OF COMPANIES

The analyses in the preceding chapter indicate that there is sufficient information, either already in the detailed schedules of the Convention Blank or readily generated by the companies, to enable life insurance companies to prepare financial statements which conform with generally accepted accounting principles. This conclusion assumes, however, that certain technical problems could be solved at the company level. Before research designed to solve those technicalities can be recommended, evidence on more than just six domestic companies is needed that such statements would be a material improvement in the measurement of earnings. This measurement has become one of the key elements under generally accepted accounting principles but has received little attention in the reports of insurance companies.

Two groups of companies are analyzed in this chapter in an effort to extend the test of the materiality of the proposed statements over a wide range of companies. The first group consists of all of the remaining stock life insurance companies in Nebraska[1] which are not included in the detailed analyses of the preceding chapter. All of the pertinent Nebraska companies are thus included in the study, thereby eliminating the possibility of distortion through selection of the companies for the detailed analysis. The

---

[1]Excluding those companies which are so inactive, so new, or so highly specialized in an unusual type of policy that application of the adjustments to their operations would not add meaning to this study.

second group consists of ten foreign companies ranging in size from the largest stock company in the United States[1] down through three which are smaller than Company F. These are companies which have, with one exception, large numbers of stockholders and whose stock is actively traded. The degree of improvement in data needed by stockholders of such companies is the very heart of this study.

All of the adjustments which were developed and verified in the detailed analyses of the preceding chapter are applied to the firms studied in this chapter, but the detailed worksheets and the extended and revised financial statements are no longer required. Instead, a new Exhibit A, which is almost identical to Exhibit II of the preceding chapter, is prepared. It, like Exhibit II, is supported by a detailed schedule of adjustments. Exhibit A emphasizes (1) a comparison of the amount of earnings reported in the Convention Blank with the earnings which would be reported under generally accepted accounting principles and (2) a reconciliation of the revised retained earnings and paid-in surplus balances with the legal surplus computed in the Convention Blank.

The caveat which has been repeatedly sounded in prior chapters regarding exclusion of the effect of factors such as income taxes and other items for which information is available only at the company level is equally applicable to all expressions regarding conformance with generally accepted accounting principles in this chapter.

THE REMAINING NEBRASKA COMPANIES

Most of the remaining Nebraska companies are firms which have been formed recently, so were not selected for the ten-year analysis in detail.

---

[1] In terms of admitted assets.

However, the analysis of one firm which has been in business for many years was deferred to this chapter in order to test the abbreviated analysis on a substantial company where the Convention Blanks are available for more than five years.[1]

All of the types of adjustments which are given effect in Schedule 1 for each company have already been discussed in the preceding chapters, the only new adjustments being those required by technical variation in detailed procedure by the companies. Discussion is therefore limited to a brief resume of the nature of the firm's primary insurance activity, its underwriting policy and other factors which need to be kept in mind in interpreting Exhibit A. That Exhibit summarizes the result of the analyses more effectively than would expository explanation and Schedule 1 gives adequate supporting detail.

The companies are discussed in ascending order of admitted assets. This permits the analysis to start with the simplest situations and move to the more complex.

Company G

Life Insurance Company G was formed by the merger of two burial associations in 1957. The reserves of the burial associations were based in part on the net level method, but most current business is valued on the Commissioners Reserve Valuation Method. Total premiums written during 1962 were:

Life insurance	$54,689.36
Accident and health insurance	30,873.20
Total	$85,562.56

[1]As has been previously noted, the Nebraska Insurance Department retains the Convention Blanks on foreign companies for only five years.

Total capital was $150,000 and Surplus $37,500 at the time the company commenced business in 1957. $60,000 of this ($50,000 capital stock and $10,000 Surplus) was obtained from sale of stock at that time and the remainder was the capital and surplus of the burial associations.

Life Insurance Company G
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1957	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) From Operations per Convention Blank	$(10,551.54)	$(4,632.08)	$10,492.56	$ 8,347.69	$ 2,879.17	$ 4,844.63	$11,380.43
Items Entered Direct to Surplus on Convention Blank:							
Capital gains (losses) on assets sold	(15.63)	50.00	(75.00)	-	(8.90)	3,457.10	
Change in value of securities owned at end of year	(2,233.32)	9,072.82	1,923.37	(538.94)	8,642.28	(5,251.53)	
Change in value of non-admitted assets and related items	(3,452.05)	(2,227.99)	(2,534.08)	693.67	(2,409.20)	(9,107.93)	
Net per Convention Blank before items classed as dispositions of income	$(16,292.54)	$ 2,262.75	$ 9,806.85	$ 8,502.42	$ 9,103.35	$(6,057.73)	7,325.10
Adjustments (see Schedule 1 for detail):							
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ (330.08)	$ 1,431.59	$ 2,128.38	$(1,129.22)	$ 1,433.88	$ 9,010.92	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	2,933.43	(8,334.00)	(1,794.67)	538.94	(8,642.28)	5,251.53	
Group III--Provide for possible losses on certain assets	(37.00)	(217.04)	(225.71)	112.92	(143.39)	(901.09)	
Group IV--Defer a portion of acquisition costs to future periods	7,538.95	8,404.26	6,235.12	4,653.54	3,645.51	(5,648.16)	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	3,076.08	57.58	277.00	435.55	975.32	(97.01)	
Total adjustments	$ 13,181.38	$ 1,342.39	$ 6,620.12	$ 4,611.73	$(2,730.96)	$ 7,616.19	30,640.85
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ (3,111.16)	$ 3,605.14	$16,426.97	$13,114.15	$ 6,372.39	$ 1,558.46	37,965.95
Dispositions of Income:							
Transfers to appropriated surplus:							
Mandatory securities valuation reserve	758.70	5,420.18	361.40	(135.56)	2,147.82	(1,287.87)	
Net addition to (reduction of) unrestricted retained earnings	$ (3,869.86)	$(1,815.04)	$16,065.57	$13,249.71	$ 4,224.57	$ 2,846.33	
Beginning Unrestricted Retained Earnings	24,158.38	20,288.52	18,473.48	34,539.05	47,788.76	52,013.33	
Ending Unrestricted Retained Earnings	$ 20,288.52	$18,473.48	$34,539.05	$47,788.76	$52,013.33	$54,859.66	
Ending Paid-in Surplus	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	10,000.00	
Total	$ 30,288.52	$28,473.48	$44,539.05	$57,788.76	$62,013.33	$64,859.66	
Ending Unassigned Surplus per Convention Blank	17,252.20	14,094.77	23,540.22	32,178.20	39,133.73	34,363.87	
Difference	$ 13,036.32	$14,378.71	$20,998.83	$25,610.56	$22,879.60	$30,495.79	
Proof:							
Difference at beginning of year	$ (145.06)	$13,036.32	$14,378.71	$20,998.83	$25,610.56	$22,879.60	$ (145.06)
Adjustments this year	13,181.38	1,342.39	6,620.12	4,611.73	(2,730.96)	7,616.19	30,640.85
Difference at end of year, as above	$ 13,036.32	$14,378.71	$20,998.83	$25,610.56	$22,879.60	$30,495.79	$30,495.79

Life Insurance Company G
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 1-14-57	1957	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):							
4. Agents' debit balances	$ -	$ 370.03	$ 2,170.41	$ 2,257.08	$(1,129.22)	$ 1,433.88	$ 9,010.92
5. Premium notes, etc. in excess of net value and other policy liabilities on individual policies	1,567.63	(700.11)	(738.82)	(128.70)	-	-	-
Total Group I adjustments	$ 1,567.63	$ (330.08)	$ 1,431.59	$ 2,128.38	$(1,129.22)	$ 1,433.88	$ 9,010.92
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:							
21. Stocks	$(1,992.20)	$ 2,933.43	$(8,334.00)	$(1,794.67)	$ 538.94	$(8,642.28)	$ 5,251.53
Group III--Provide for possible losses on certain assets:							
30. Agents' debit balances (estimated at 10%)	$ -	$ (37.00)	$ (217.04)	$ (225.71)	$ 112.92	$ (143.39)	$ (901.09)
Group IV--Defer a portion of acquisition costs to future periods:							
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$ -	$ 826.70	$ 3,874.14	$10,306.59	$10,877.51	$ 1,364.16	$(6,020.30)
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	-	5,589.17	3,601.83	(5,610.05)	(2,816.85)	1,215.20	(537.04)
42. Accident and health insurance direct acquisition cost (deferred in the same manner as Item 41)	-	1,123.08	928.29	1,538.58	(3,407.12)	1,066.15	909.18
Total Group IV adjustments	$ -	$ 7,538.95	$ 8,404.26	$ 6,235.12	$ 4,653.54	$ 3,645.51	$(5,648.16)
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:							
52. Reverse entry for change in net book value of furniture and equipment	$ 279.51	$ 3,076.08	$ 57.58	$ 277.00	$ 435.55	$ 975.32	$ (97.01)
Total Adjustments	$ (145.06)	$13,181.38	$ 1,342.39	$ 6,620.12	$ 4,611.73	$(2,730.96)	$ 7,616.19

Company H

Life Insurance Company H was organized as a capital stock legal reserve company in 1960 but did not commence business until 1961. One million shares of $1.00 par are authorized, but as of December 31, 1962, only 100,255 shares had been issued. Of the proceeds, $100,255 was credited to capital stock and $350,892.50 to surplus.

The company writes life insurance only. At the end of 1962, approximately $4 million of insurance was in force. Just under $200,000 was term insurance and the balance whole life and endowment. All of the reserves are valued on one of the preliminary term methods, primarily the Commissioners Reserve Valuation Method using the 1941 CSO table of mortality and 3% interest.

Premiums written in 1962 totaled $181,266. The net gain (loss) from operations per the Convention Blank was thus a loss of roughly 50 per cent of the premiums received, in spite of the fact that preliminary term reserve methods are used. Even under generally accepted accounting principles, as applied in this study and subject to the limitations imposed, the loss is equal to over 35 per cent of premiums.

Life Insurance Company H
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With
"Generally Accepted Accounting Principles" — Exhibit A

	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$ (73,504.46)	$ (90,020.97)	$(163,525.43)
Items Entered Direct to Surplus on Convention Blank:			
Change in value of securities owned at end of year	-	(25,000.00)	
Change in value of non-admitted and related items	(33,218.21)	5,232.72	
Net per Convention Blank before items classed as dispositions of income	$(106,722.67)	$(109,788.25)	(216,510.92)
Adjustments:			
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 16,066.59	$ 21,116.83	
Group III--Provide for possible losses on certain assets	(1,324.54)	231.48	
Group IV--Defer a portion of acquisition costs to future periods	39,950.78	24,256.69	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	17,151.62	(1,349.55)	
Total adjustments	$ 71,844.45	$ 44,255.45	116,099.90
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ (34,878.22)	$ (65,532.80)	(100,411.02)
Dispositions of Income:			
Transfers to appropriated surplus:			
Mandatory securities valuation reserve	308.86	350.25	
Net addition to (reduction of) unrestricted retained earnings	$ (35,187.08)	$ (65,883.05)	(101,070.13)
Beginning Unrestricted Retained Earnings	-	(35,187.08)	
Ending Unrestricted Retained Earnings	$ (35,187.08)	$(101,070.13)	
Ending Paid-in Surplus (net of commissions)	350,892.50	350,892.50	
Total	$ 315,705.42	$ 249,822.37	
Ending Unassigned Surplus per Convention Blank	243,860.97	133,722.47	
Difference	$ 71,844.45	$ 116,099.90	
Proof:			
Difference at beginning of year	$ -	$ 71,844.45	$ -
Adjustments this year	71,844.45	44,255.45	116,099.90
Difference at end of year, as above	$ 71,844.45	$ 116,099.90	$ 116,099.90

Life Insurance Company H
Detailed Schedule of Adjustments
To Make the Financial Statements Agree With
"Generally Accepted Accounting Principles"

Schedule 1

Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):		
3. Loans considered inadmissible	$ -	$25,000.00
4. Agents' debit balances	13,245.44	(2,314.77)
6. Prepaid expenses	2,821.15	(1,568.40)
Total Group I adjustments	$16,066.59	$21,116.83
Group III--Provide for possible losses on certain assets:		
30. Agents' debit balances (estimated at 10%)	(1,324.54)	231.48
Group IV--Defer a portion of acquisition costs to future periods:		
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	39,950.78	24,256.69
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:		
52. Reverse entry for change in net book value of furniture and equipment	17,151.62	(1,349.55)
Total Adjustments	$71,844.45	$44,255.45

Company I

This company is another of the new firms. It was organized in late 1961. Like Company H, it sustained a loss even after adjustment to conformance with generally accepted accounting principles.

Unlike many new firms, Company I values a substantial portion of its reserves on the net level premium plan. The life insurance reserves at December 31, 1962, were valued by the following methods, using CSO mortality tables and 3% interest assumption for all except a few policies:

Net level premium method:		
Ordinary life insurance	$48,942	
Credit life insurance	5,410	$54,352
Modified preliminary term methods:		
Commissioners reserve valuation method	$ 3,136	
New Jersey standard method	1,550	4,686
Reinsurance assumed		11,500
Total		$70,538

Total premiums were $126,688 in 1962. By contrast, Company J, which also commenced business in 1961 but uses preliminary term methods for most of its policies, earned $662,353 in premiums in 1962 but has reserves of only $20,497. This comparison illustrates the impact of reserve methods on the reported earnings of new companies. It underscores the need for research into the possibility of basing Adjustment 40 on the portion of direct acquisition costs not compensated for by the difference between the reserve methods used and net level premium methods, rather than on the entire first-year commission.

Life Insurance Company I
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With
"Generally Accepted Accounting Principles" Exhibit A

	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$ (4,383.05)	$(233,234.82)	$(237,617.87)
Items Entered Direct to Surplus on Convention Blank:			
Change in value of securities owned at end of year	-	(5,727.35)	
Change in value of non-admitted and related items	-	(59,066.27)	
Net per Convention Blank before items classed as dispositions of income	$ (4,383.05)	$(298,028.44)	(302,411.49)
Adjustments:			
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ -	$ 61,506.96	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	-	3,300.00	
Group III--Provide for possible losses on certain assets	-	(5,592.66)	
Group IV--Defer a portion of acquisition costs to future periods	-	32,988.74	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	-	1,006.57	
Total adjustments	$ -	$ 93,209.61	93,209.61
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ (4,383.05)	$(204,818.83)	(209,201.88)
Dispositions of Income:			
Transfers to appropriated surplus:			
Mandatory securities valuation reserve	$ -	$ 965.56	
Net addition to (reduction of) unrestricted retained earnings	$ (4,383.05)	$(205,784.39)	
Beginning Unrestricted Retained Earnings	-	(4,383.05)	
Ending Unrestricted Retained Earnings	$ (4,383.05)	$(210,167.44)	
Ending Paid-in Surplus (net of commissions)	500,000.00	600,000.00	
Total	$495,616.95	$ 389,832.56	
Ending Unassigned Surplus per Convention Blank	495,616.95	296,622.95	
Difference	$ -	$ 93,209.61	
Proof:			
Difference at beginning of year	$ -	$ -	$ -
Adjustments this year	-	93,209.61	93,209.61
Difference at end of year, as above	$ -	$ 93,209.61	$ 93,209.61

Life Insurance Company I
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With
"Generally Accepted Accounting Principles"

Schedule 1

	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):		
1. Supplies, stationery and printed matter		$ 2,794.39
4. Agents' debit balances		55,926.60
5. Premium notes in excess of net value and other policy liabilities on individual policies		2,427.35
9. Returned checks		345.28
10. Miscellaneous debits		13.34
Total Group I adjustments		$61,506.96
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:		
21. Stocks		3,300.00
Group III--Provide for possible losses on certain assets:		
30. Agents' debit balances (estimated at 10%)		(5,592.66)
Group IV--Defer a portion of acquisition costs to future periods:		
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)		32,988.74
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:		
50. Record furniture and equipment		1,059.55
51. Record depreciation of furniture and equipment		(52.98)
Total Group V adjustments		$ 1,006.57
Total Adjustments		$93,201.69

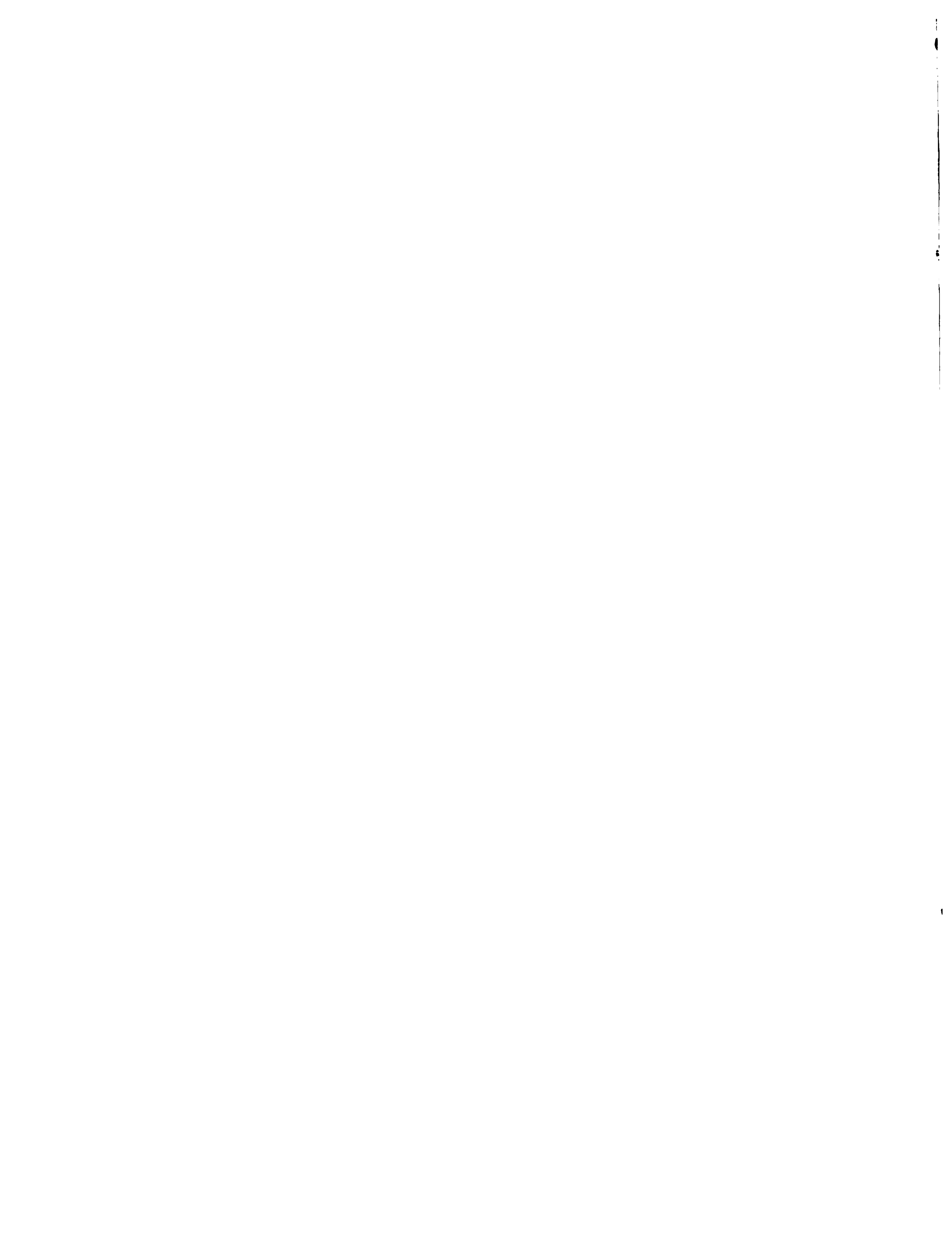
Company J

Life Insurance Company J is the last of the companies which commenced business in 1961 included in this study.[1] This firm was organized by another corporation, which purchased most of the first 1,500,000 shares of 10¢ par stock issued at 13 1/3 cents per share. Bests' report, however, that these shares are marked and that they cannot share in the assets of the company in case of dissolution until other shares have been reimbursed the full purchase price for a period ending September 15, 1968. One million shares were offered and sold to the public in late 1961 and early 1962 at 99 cents per share, thus creating a substantial paid-in surplus.

In contrast to the two preceding companies, a profit is shown in 1962 when earnings are revised to conform with generally accepted accounting principles. Almost 99% of reserves are determined by the Commissioners Reserve Valuation Method with a 3% assumed interest rate, so the portion allocated to reserves is extremely small. As was noted in the discussion of Company I, premiums earned in 1962, all life, totaled $662,353.12 but total reserves at the end of the year were only $20,497.00. Insurance in force on that date was over $17 1/2 million.

---

[1]Two companies which were formed in 1962 are excluded from this study because operations of less than a full year do not provide a meaningful analysis.



Life Insurance Company J
Adjustment of Gain from Operations and Changes in Surplus per Convention Blank To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$(38,374.60)	$ (77,504.59)	$(115,879.19)
Items Entered Direct to Surplus on Convention Blank:			
Capital gains (losses) on assets sold	-	912.26	
Change in value of securities owned at end of year	-	(1,727.18)	
Change in value of non-admitted assets and related items	(7,456.87)	(14,820.66)	
Net per Convention Blank before items classed as dispositions of income	$(45,831.47)	$ (93,140.17)	(138,971.64)
Adjustments (See Schedule 1 for detail):			
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 1,466.77	$ 5,088.80	
Group III--Provide for possible losses on certain assets	(13.42)	(416.14)	
Group IV--Defer a portion of acquisition costs to future periods	-	304,888.83	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	5,990.10	11,087.28	
Total adjustments	$ 7,443.45	$ 320,648.77	328,092.22
Net income (loss) computed in conformance with "generally accepted accounting principles"	$(38,388.02)	$ 227,508.60	189,120.58
Dispositions of Income:			
Transfers to appropriated surplus:			
Mandatory securities valuation reserve	-	858.52	
Net addition to (reduction of) unrestricted retained earnings	$(38,388.02)	$ 226,650.08	
Beginning Unrestricted Retained Earnings	-	(38,388.02)	
Ending Unrestricted Retained Earnings	$(38,388.02)	$ 188,262.06	
Ending Paid-in Surplus (net of commissions)	161,177.89	864,867.25	
Total	$122,789.87	$1,053,129.31	
Ending Unassigned Surplus per Convention Blank	115,346.42	725,037.09	
Difference	$ 7,443.45	$ 328,092.22	
Proof:			
Difference at beginning of year	$ -	$ 7,443.45	$ -
Adjustment	7,443.45	320,648.77	328,092.22
Difference at end of year	$ 7,443.45	$ 328,092.22	$ 328,092.22

Life Insurance Company J
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With
"Generally Accepted Accounting Principles"

Schedule 1

	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):		
2. Advances to agents or officers	$ 404.94	$ 677.71
4. Agents' debit balances	134.15	4,161.38
6. Expenses paid in advance	-	316.54
7. Bills receivable	50.38	(50.38)
10. Miscellaneous debits	877.30	(16.45)
Total Group I adjustments	$1,466.77	$ 5,088.80
Group III--Provide for possible losses on certain assets:		
30. Agents' debit balances (estimated at 10%)	(13.42)	(416.14)
Group IV--Defer a portion of acquisition costs to future periods:		
40. First year life insurance commissions	-	304,888.83
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:		
52. Reverse entry for change in net book value of furniture and equipment	5,990.10	11,087.28
Total Adjustments	$7,443.45	$320,648.77

Company K

When earnings are computed in conformance with generally accepted accounting principles, as applied in this study, Company K shows a profit every year. This is in marked contrast with the losses of Companies H and I but consistent with the second year for Company J. Even though this profit measurement is imperfect, it gives a better indication of operating results than the Convention Blank, which shows that all of the firms sustained operating losses each year. The profits computation must, however, be tempered by recognition that over 99 per cent of the reserves are valued on the Commissioners Reserve Valuation Method using the 1941 CSO mortality table with a 3% interest assumption. As has been repeatedly pointed out, research is needed at the company level into the possibility of making Adjustment 40 for only the portion of direct acquisition costs not offset by the difference between the reserve methods used and net level premium methods. If this can be done, earnings statements could be conservative but nevertheless reliable indicators of whether a new firm is making progress.

Approximately 77 per cent of the insurance in force is a special 20 payment life insurance. All other policies are non-participating and include the usual ordinary life, term and limited payment life insurance plans. Over $16 1/2 million of insurance is in force. No accident and health insurance has been written even though permitted by the certificate of authority.

The original capital of the firm was obtained from the sale of 304,270 shares of 50¢ par stock for $2.50 per share less a 10% commission. An additional 126,567 shares were issued under option contracts at $2.50 per share in 1962.

Life Insurance Company K
Adjustment of Gain from Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$(29,819.05)	$ (27,848.61)	$(80,750.08)	$(138,417.74)
Items Entered Direct to Surplus on Convention Blank:				
Capital gains (losses) on assets sold	2,796.88	2,731.73	233.80	
Change in value of securities owned at end of year	(533.08)	3,985.19	(3,046.30)	
Change in value of non-admitted and related items	(38,349.68)	(128,908.88)	(7,935.99)	
Net per Convention Blank before items classed as dispositions of income	$(65,904.93)	$(150,040.57)	$(91,498.57)	(307,444.07)
Adjustments (see Schedule 1 for detail):				
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 25,326.93	$ 128,723.46	$ 6,797.41	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	533.08	(3,985.19)	3,046.30	
Group III--Provide for possible losses on certain assets	(2,447.68)	(10,462.35)	(1,379.74)	
Group IV--Defer a portion of acquisition costs to future periods	70,695.63	158,437.42	148,376.94	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	13,022.75	1,039.67	1,138.58	
Total adjustments	$107,130.71	$ 273,753.01	$157,979.49	538,863.21
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ 41,225.78	$ 123,712.44	$ 66,480.92	231,419.14
Dispositions of Income:				
Transfers to appropriated surplus:				
Mandatory securities valuation reserve	2,803.98	6,697.16	(1,899.38)	
Net addition to (reduction of) unrestricted retained earnings	$ 38,421.80	$ 117,015.28	$ 68,380.30	
Beginning Unrestricted Retained Earnings	-	38,421.90	155,437.18	
Ending Unrestricted Retained Earnings	$ 38,421.80	$ 155,437.18	$223,817.48	
Ending Paid-in Surplus (net of commissions and organization costs)	529,173.97	530,648.87	751,958.62	
Total	$567,595.77	$ 686,086.05	$975,776.10	
Ending Unassigned Surplus per Convention Blank	460,465.06	305,202.33	436,912.89	
Difference	$107,130.71	$ 380,883.72	$538,863.21	
Proof:				
Difference at beginning of year	$	$ 107,130.71	$380,883.72	$
Adjustments this year	107,130.71	273,753.01	157,979.49	538,863.21
Difference at end of year, as above	$107,130.71	$ 380,883.72	$538,863.21	$ 538,863.21

Life Insurance Company K
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With
"Generally Accepted Accounting Principles"

Schedule 1

	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):			
2. Advances to agents or officers	$ -	$ 24,100.00	$ (7,000.00)
4. Agents' debit balances	24,472.68	104,623.46	13,797.41
7. Bills receivable	854.25	-	-
Total Group I adjustments	$ 25,326.96	$128,723.46	$ 6,797.41
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:			
21. Stocks	533.08	(3,985.19)	3,046.30
Group III--Provide for possible losses on certain assets:			
30. Agents' debit balances (estimated at 10%)	(2,447.68)	(10,462.35)	(1,379.74)
Group IV--Defer a portion of acquisition costs to future periods:			
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	70,695.63	158,437.42	148,376.94
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:			
52. Reverse entry for change in net book value of furniture and equipment	13,022.75	1,039.67	1,138.58
Total Adjustments	$107,130.71	$273,753.01	$157,979.49

Company L

Several interesting activities need to be reflected in the financial statements of this firm if stockholders are to have a complete report of accountability from management.

Merger

The original company was owned by one family and a few key employees. In 1958 the stock of this company was purchased by a foreign firm which had been organized in 1955, and the two firms were merged. The old Nebraska (Northern) company was the surviving corporation. The transactions of the "Southern" company during 1958 can best be summarized by using the type of T accounts which are used for instructional and analytical purposes in accounting.

Cash

Debit		Credit	
(a)	$6,231,750	(b)	$6,249,250
		(c)	5,240,000

Notes Payable to Banks

Debit		Credit	
(c)	$5,240,000	(a)	$6,231,750

Stock in "Northern" Company

Debit		Credit	
(b)	$6,249,250	(d)	$6,249,250

Surplus

Debit		Credit	
(d)	$6,249,250		

Explanation of Transactions:
- (a) Borrowed from bank.
- (b) Purchased stock from stockholders of old Nebraska (Northern) company.
- (c) Portion of bank loan repaid by the end of 1958.
- (d) Stock of "Northern" company exchanged for new stock and distributed to stockholders of "Southern" company.

Since insurance companies carry only one surplus account, the above entries sufficed. At the end of 1958 both the "Northern" and "Southern" divisions prepared its own Convention Blank in the usual way. Then, the two were simply added together. This procedure was essentially that of a pooling of interests.

This simple procedure cannot be used when generally accepted accounting principles are followed because the surplus account must be split so as to reflect contributed surplus and earnings. A serious question arises as to whether the entire $6,249,250 must be charged against retained earnings, or whether the portion in excess of the balance in retained earnings can be charged against paid-in surplus. The basic facts are that funds, part of which had originally been contributed by stockholders to the new Southern Company, were used to purchase the stock of the old Northern Company and that stock was, in turn, exchanged for stock which was distributed to the stockholders of the Southern Company. The Southern Company stockholders thus received a dividend in the form of stock in the merged company. These facts should be discernable from the procedure used in Exhibit A, but this does not mean that the alternative procedure of charging part of the cost of the stock against paid-in surplus would be unacceptable if accompanied by proper resolutions of the directors and adequate disclosure in the statements.

Assets received in exchange for stock

The original stockholders of the Southern Company exchanged land and mortgage loans for stock in the company. Some of these assets had to be treated as non-admitted assets in the opening Convention Blank. As a result, the Group I adjustments are extraordinarily large.

Underwriting and reserves

The trend of earnings cannot be properly evaluated without first considering changes in reserve valuation methods because these methods have a profound effect on the portion of premiums taken up as revenue in the first years of a policy. The reserves at December 31, 1962, were comprised of:

	Modal Interest Rate Assumption	Per Cent Of Total Reserves	Per Cent Of Reserve Plans Currently Used For New Business
Reserve valuation plans no longer used for new business:			
Net level	3 1/2%	44%	
Modified preliminary term	3 1/2	12	
Select and ultimate	3 1/2	1	
Full preliminary term	3 1/2	5	
Reserve valuation plans currently used for new business:			
1941 CSO mortality table:			
Net level	3	4	11%
Commissioners reserve valuation method	3	34	89
1958 CSO mortality table:			
Net level	3	*	*
Commissioners reserve valuation method	3 1/2	*	*
		100%	100%

* = Less than 1%.

Accident and health insurance premiums comprise less than 10 per cent of total premiums. Approximately 40 per cent of the business written in 1962 was term insurance and nearly one-fourth of the insurance in force is term. On these policies, the portion transferred to reserves is small so most of the premium is included in revenue.

Total premiums written during 1962 totaled $4.8 million. Life insurance in force at the end of 1962 was $262 million.

Accumulated depreciation

The old Nebraska (Northern) company always charged the cost of furniture and equipment to expense when purchased. The Southern company

capitalized these items and depreciated them. The method of handling the accumulated depreciation provides another example of the attitude underlying much of insurance accounting and reporting that almost anything is acceptable if it decreases legal surplus. The examiner's report states:

> In its 1958 annual statement, the Company included as a liability a . . . reserve for depreciation of furniture and equipment of $10,000. It also deducted the entire book value of furniture and equipment as an asset not admitted. The items were accorded the same treatment in the financial statements of this report.

The same procedure was followed for aircraft, automobiles and farm equipment. Leaving the reserve among the liabilities while deducting the full cost of the assets as a non-admitted asset reduces surplus below what it would be if the cost were expensed when the asset was acquired. Fortunately, this practice has been abandoned, but the very fact that it was followed as late as five years ago and was not considered serious enough to warrant change in the examiner's report is indicative of the underlying philosophy stated above.

Life Insurance Company L
(Old Company Before Merger)
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1953	1954	1955	1956	1957	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$ 226,982.64	$ 175,244.89	$ 228,820.18	$ 298,365.80	$ 343,175.60	$1,272,589.11
Items Entered Direct to Surplus on Convention Blank:						
Capital gains (losses) on assets sold	-	31,359.06	19,671.67	8,567.94	438.08	
Change in value of securities owned at end of year	38,148.04	57,758.51	11,201.18	(50,788.67)	(35,071.57)	
Change in value of non-admitted and related items	(10,599.63)	(13,966.98)	(26,649.86)	(20,219.03)	1,390.00	
Net per Convention Blank before items classed as dispositions of income	$ 254,531.05	$ 250,395.48	$ 233,043.17	$ 235,926.04	$ 309,932.11	1,283,827.85
Adjustments (see Schedule 1 for detail):						
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 10,599.63	$ 11,851.63	$ 25,880.71	$ 20,502.05	$ (1,381.68)	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	(420.00)	(42,429.24)	(8,246.04)	57,202.67	37,873.24	
Group III--Provide for possible losses on certain assets	(663.20)	(1,529.57)	(2,607.53)	(1,809.22)	(61.55)	
Group IV--Defer a portion of acquisition costs to future periods	495.64	3,267.86	18,459.42	(8,746.36)	(9,406.32)	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	5,114.96	925.41	10,092.28	2,720.18	1,735.77	
Total adjustments	$ 15,127.03	$ (27,913.91)	$ 43,578.84	$ 69,869.32	$ 28,759.46	129,420.74
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ 269,658.08	$ 222,481.57	$ 276,622.01	$ 305,795.36	$ 338,691.57	1,413,248.59
Dispositions of Income:						
Transfers to appropriated surplus:						
Mandatory securities valuation reserve	$ 112,974.65	$ 85,270.06	$ 30,380.91	$ 15,934.57	$ 8,598.52	
Contingency reserve	-	50,000.00	-	-	-	
Dividends to stockholders	130,000.00	30,000.00	231,000.00	48,000.00	52,000.00	
Total dispositions of income	$ 242,974.65	$ 165,270.06	$ 261,380.91	$ 63,934.57	$ 60,598.52	
Net addition to (reduction of) unrestricted retained earnings	$ 26,683.43	$ 57,211.51	$ 15,241.10	$ 241,860.79	$ 278,093.05	
Beginning Unrestricted Retained Earnings	1,965,084.76	1,991,768.19	2,048,979.70	2,064,220.80	2,306,081.59	
Ending Unrestricted Retained Earnings	$1,991,768.19	$2,048,979.70	$2,064,220.80	$2,306,081.59	$2,584,174.64	
Ending Unassigned Surplus per Convention Blank	1,424,485.17	1,509,610.59	1,481,272.85	1,653,264.32	1,902,597.91	
Difference	$ 567,283.02	$ 539,369.11	$ 582,947.95	$ 652,817.27	$ 681,576.73	
Proof:						
Difference at beginning of year	$ 552,155.99	$ 567,283.02	$ 539,369.11	$ 582,947.95	$ 652,817.27	$ 552,155.99
Adjustments this year	15,127.03	(27,913.91)	43,578.84	69,869.32	28,759.46	129,420.74
Difference at end of year	$ 567,283.02	$ 539,369.11	$ 582,947.95	$ 652,817.27	$ 681,576.73	$ 681,576.73

Life Insurance Company L
(Old Company Before Merger)
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 12-31-52	1953	1954	1955	1956	1957
Group I--Place non-admitted assets on the statements (other than fixed assets, which are in Group V):						
4. Agents' debit balances	$ 47,024.78	$ 6,632.00	$ 15,295.70	$ 26,075.30	$ 18,092.23	$ 615.46
5. Premium notes, etc. in excess of net value and other policy liabilities on individual policies	1,389.39	3,131.44	(2,115.35)	(769.15)	283.02	8.32
7. Bills receivable	2,055.96	836.19	(1,328.72)	574.56	2,126.80	(2,005.46)
Total Group I adjustments	$ 50,470.13	$10,599.63	$ 11,851.63	$ 25,880.71	$ 20,502.05	$ (1,381.68)
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:						
20. Bonds	$ 57,512.50	$(2,250.00	$ 775.46	$ 2,934.00	$ 21,997.22	$ 18,661.45
21. Stocks	67,618.74	1,830.00	(43,204.70)	(11,180.04)	35,205.45	19,211.79
Total Group II adjustments	$125,131.24	$ (420.00)	$(42,429.24)	$ (8,246.04)	$ 57,202.67	$ 37,873.24
Group III--Provide for possible losses on certain assets:						
30. Agents' debit balances	$ (4,702.48)	$ (663.20)	$ (1,529.57)	$ (2,607.53)	$ (1,809.22)	$ (61.55)
Group IV--Defer a portion of acquisition costs to future periods:						
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$367,139.35	$ 495.64	$ 3,267.86	$ 17,548.93	$(11,226.85)	$(10,626.24)
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	-	-	-	910.49	2,480.49	1,219.92
Total Group IV adjustments	$367,139.35	$ 495.64	$ 3,267.86	$ 18,459.42	$ (8,746.36)	$ (9,406.32)
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:						
50. Record furniture and equipment	$ 22,131.80	$ 7,713.83	$ 4,115.76	$ 14,198.33	$ 7,668.09	$ 6,998.76
51. Record depreciation of furniture and equipment	(8,014.05)	(2,598.87)	(3,190.35)	(4,106.05)	(4,947.91)	(5,262.99)
Total Group V adjustments	$ 14,117.75	$ 5,114.96	$ 925.41	$ 10,092.28	$ 2,720.18	$ 1,735.77
Total Adjustments	$552,155.99	$15,127.03	$(27,913.91)	$ 43,578.84	$ 69,869.32	$ 28,759.46

Life Insurance Company L
(New Southern Company and Merged Companies)
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	New Southern Company Before Merger				Merged Companies					
	1955	1956	1957	Aggregate of Key Items	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$ 17,964.69	$ 1,284.95	$ (85,931.63)	$ (66,681.99)	$ 85,518.77	$ 258,584.16	$ 286,902.01	$ 246,755.17	$ 261,668.32	$1,139,428.43
Items Entered Direct to Surplus on Convention Blank:										
Capital gains (losses) on assets sold	10,819.97	18,946.44	22,006.37		(31,492.73)	(4,028.12)	(548.56)	(113,859.94)	(228.56)	
Change in value of securities owned at end of year	-	-	-		765,331.21	25,550.99	41,439.98	81,406.10	385,038.56	
Change in value of non-admitted and related items	983,017.11	(26,108.10)	(56,993.16)		(411,221.43)	113,968.68	269,546.63	(86,836.90)	(319,312.06)	
Net per Convention Blank before items classed as dispositions of income	$ 1,011,801.77	$ (5,876.71)	$ (120,918.42)	885,006.64	$ 408,135.82	$ 394,075.71	$ 597,340.06	$ 127,464.43	$ 327,166.26	1,854,182.28
Adjustments (see Schedule 1 for detail):										
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$(1,065,678.90)	$ (55,657.92)	$ (24,538.40)		$ 15,624.50	$ 369,937.22	$ (270,511.40)	$ 68,474.92	$ 61,754.17	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	-	-	-		(286,330.73)	(121,111.09)	(41,328.87)	(38,943.27)	(182,889.84)	
Group III--Provide for possible losses on certain assets	(3,039.76)	(8,619.92)	(6,002.75)		(4,490.57)	(1,696.23)	(14,709.14)	(18,918.83)	(26,182.01)	
Group IV--Defer a portion of acquisition costs to future periods	22,139.04	96,812.94	148,872.72		74,000.96	69,572.11	34,302.18	92,070.37	122,861.27	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	82,661.79	81,766.02	81,531.56		(36,211.30)	(80,763.53)	551.93	18,216.41	55,409.17	
Total adjustments	$ (963,917.83)	$ 114,301.12	$ 199,863.13	(649,753.58)	$ (237,407.14)	$ 235,938.48	$ (291,695.30)	$ 120,899.60	$ 30,952.76	(141,311.60)
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ 47,883.94	$ 108,424.41	$ 78,944.71	235,253.06	$ 170,728.68	$ 630,014.19	$ 305,644.76	$ 248,364.03	$ 358,119.02	1,712,870.68
Dispositions of Income:										
Transfers to appropriated surplus:										
Mandatory securities valuation reserve	$ 889,493.17	$ (215,556.63)	$ (129,295.45)		$ (615,063.10)	$ 1,765.68	$ 43,595.08	(34,031.69)	322,645.50	
Reserve for contingencies	-	-	-		(1,250,000.00)	-	-	-	-	
Reserve strengthening--deficiency	-	-	60,443.00		44,987.00	60,216.42	69,843.69	102,319.89	(3,611.00)	
Payment for Old Company stock	-	-	-		6,249,250.00	-	-	-	-	
Dividends to stockholders	-	210,000.00	-		56,000.00	70,002.10	127,910.62	144,075.90	115,580.72	
Total dispositions of income	$ 889,493.17	$ (5,556.63)	$ (68,852.45)		$ 4,485,173.90	$ 131,984.20	$ 241,349.39	$ 212,364.10	$ 434,615.22	
Net addition to (reduction of) unrestricted retained earnings	$ (841,609.23)	$ 113,981.04	$ 147,797.16		$(4,314,445.22)	$ 498,029.99	$ 64,295.37	$ 35,999.93	$ (76,496.20)	
Beginning Unrestricted Retained Earnings	-	(841,609.23)	(727,628.19)		2,004,343.61	(2,310,101.61)	(1,812,041.62)	(1,747,746.25)	(1,711,746.32)	
Ending Unrestricted Retained Earnings	$ (841,609.23)	$ (727,628.19)	$ (579,831.03)		$(2,310,101.61)	$(1,812,071.62)	$(1,747,746.25)	$(1,711,746.32)	$(1,788,242.52)	
Ending Paid-in Surplus (net of commissions)	4,408,197.95	4,411,282.79	4,430,068.94		4,449,743.44	4,509,102.60	4,643,934.36	4,643,934.36	4,662,974.36	
Total	$ 3,566,588.72	$3,683,654.60	$3,850,237.91		$ 2,139,641.83	$ 2,697,030.98	$ 2,896,188.11	$ 2,932,188.04	$ 2,874,731.84	
Ending Unassigned Surplus per Convention Blank	4,530,506.55	4,533,271.31	4,499,991.49		2,345,225.82	2,666,676.49	3,157,498.92	3,072,599.25	2,984,190.29	
Difference	$ (963,917.83)	$ (849,616.71)	$ (649,753.58)		$ (205,583.99)	$ 30,354.49	$ (261,310.81)	$ (140,411.21)	$ (109,458.45)	
Proof:										
Difference at beginning of year	$ -	$ (963,917.83)	$ (849,616.71)	$ -	$ 31,823.15	$ (205,583.99)	$ 30,354.49	$ (261,340.81)	$ (140,441.21)	$ 31,823.15
Adjustments this year	(963,917.83)	114,301.12	199,863.13	(649,753.58)	(234,407.14)	235,938.48	(291,695.30)	120,899.60	30,952.76	(141,311.60)
Difference at end of year, as above	$ (963,917.83)	$ (849,616.71)	$ (649,753.58)	$(649,753.58)	$ (205,583.99)	$ 30,354.49	$ (261,340.81)	$ (140,441.21)	$ (109,488.45)	$ (109,488.45

Life Insurance Company L
(New Southern Company and Merged Companies)
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	New Southern Company Before Merger			Merged Companies				
	1955	1956	1957	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets, which are in Group V):								
2. Advances to officers or agents	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,367.20
3. Loans considered inadmissible	-	-	-	839.58	(175.23)	349.57	6,143.33	(7,737.42)
4. Agents' debit balances	30,397.59	86,199.19	60,027.52	44,905.66	16,962.33	147,091.43	189,188.34	261,820.06
5. Premium notes, etc. in excess of net value and other policy liabilities on individual policies	-	-	-	(1,157.10)	(212.16)	(412.84)	(145.57)	-
10. Miscellaneous debits	425.00	-	-	-	-	-	-	8,453.05
15. Mortgage loans	(1,096,501.49)	(141,857.11)	(84,565.92)	(28,963.64)	353,362.28	(417,539.56)	(126,711.18)	(202,148.72)
Total Group I adjustments	$(1,065,678.90)	$ (55,657.92)	$(24,538.40)	$ 15,624.50	$ 369,937.22	$(270,511.40)	$ 68,474.92	$ 61,754.17
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:								
20. Bonds	$ -	$ -	$ -	$ (22,475.94)	$ 23,354.10	$ 13,874.20	$ 37,722.05	$ (1,033.45)
21. Stocks	-	-	-	(263,854.79)	(106,597.30)	(55,203.07)	(76,665.32)	(181,856.39)
25. Change in capital gains as a result of above adjustments	-	-	-	-	(37,867.89)	-	-	-
Total Group II adjustments	$ -	$ -	$ -	$(286,330.73)	$(121,111.09)	$ (41,328.87)	$ (38,943.27)	$(182,889.84)
Group III--Provide for possible losses on certain assets:								
30. Agents' debit balances (estimated at 10%)	$ (3,039.76)	$ (8,619.92)	$ (6,002.75)	$ (4,490.57)	$ (1,696.23)	$ (14,709.14)	$ (18,918.83)	$ (26,182.01)
Group IV--Defer a portion of acquisition costs to future periods:								
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$ 22,139.04	$ 96,812.94	$148,872.72	$ 73,996.49	$ 63,805.85	$ 33,237.81	$ 76,155.37	$ 130,405.27
41. Accident and health insurance premiums (deferred in proportion to unearned premium reserve)	-	-	-	4.47	5,766.26	1,064.37	15,915.00	(7,544.00)
Total Group IV adjustments	$ 22,139.04	$ 96,812.94	$148,872.72	$ 74,000.96	$ 69,572.11	$ 34,302.18	$ 92,070.37	$ 122,861.27
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:								
50. Record furniture and equipment	$ -	$ -	$ -	$ 4,975.19	$ -	$ -	$ -	$ -
51. Record depreciation of furniture and equipment	-	-	-	(5,525.60)	-	-	-	-
52. Reverse entry for change in net book value of furniture and equipment	23,421.71	21,457.53	16,803.37	10,702.74	(13,325.62)	13,067.62	28,118.31	59,523.97
52a. Reverse entry for change in net book value of automobiles and airplanes	11,415.69	3,489.29	23,228.73	36,816.08	3,608.22	(6,035.69)	(3,419.90)	(640.35)
53. Reverse entry for change in real estate	47,824.39	56,819.20	13,614.50	(87,848.22)	(30,409.70)	-	-	-
54. Reverse entry placing furniture and equipment on the books of the company	-	-	-	-	(34,156.43)	-	-	-
59a. Capitalize cost of remodeling	-	-	27,884.96	4,668.51	-	-	-	-
59b. Record depreciation of remodeling cost	-	-	-	-	(6,480.00)	(6,480.00)	(6,482.00)	(3,774.45)
Total Group V adjustments	$ 82,661.79	$ 81,766.02	$ 81,531.56	$ (36,211.30)	$ (80,763.53)	$ 551.93	$ 18,216.41	$ 55,409.17
Total Adjustments	$ (963,917.83)	$ 114,301.12	$199,863.13	$(237,407.14)	$ 235,938.48	$(291,695.30)	$ 120,899.60	$ 30,952.76

TEN FOREIGN COMPANIES

A sample of large stock companies was selected from the list of fifty largest life insurance companies in the United States published by Fortune.[1] Companies whose admitted assets were closest to preselected fractions and multiples of billions of dollars of admitted assets were selected from that list. Certain other firms were added because the data included in the First Boston Corporation's 1963 edition of *Data on Selected Life Insurance Company Stocks* indicated possible enrichment of the sample by such addition. The reasons for the selections are indicated in the discussion of the firms.

The Nebraska Insurance Department, in common with many other departments, retains the Convention Blanks for foreign companies for only five years. It was therefore necessary to write to the companies for the cost of furniture and equipment purchased and first-year commissions during preceding years. Not all companies submitted the data on exactly the same basis, but the Nebraska Insurance Department had not disposed of the 1957 reports. Consequently, satisfactory verification of the company's method of completing the questionnaire was possible and the same method was then used for the analysis period.[2] Since the purpose of this part of this study is to test whether or not the adjustments would likely be material in firms of all sizes if made in practice rather than to prepare completely accurate revised statements, minor variations between companies in the method of compiling the data submitted are not important.

---

[1] *The Fortune Directory--The 500 Largest U. S. Industrial Corporations and the 50 Largest Banks, Merchandising, Transportation, Life-Insurance, and Utility Companies, and the 200 Largest Foreign Industrial Corporations* (revised annually).

[2] Exceptions are noted in the discussion of the companies.

The order in which the companies are discussed follows the pattern of the preceding section of moving from the smallest to the largest firms. The first three are smaller than Company F but four of the five largest stock companies are included.

As the research progressed, the importance of the types of insurance written, underwriting policies and reserve valuation plans became more and more evident. Key factors regarding these items are, therefore, tabulated in comparative form in Appendix I for these ten foreign firms. This method of presentation allows the reader to compare the over-all situation with the other firms analyzed before attempting an evaluation of the individual statements for each firm.

Company M

This company was selected for analysis even though it is not one of the fifty largest insurance companies listed in the Fortune Directory because it had the largest percentage increase in market price of its stock of any of the twenty-four companies analyzed in the First Boston Corporation's study. The current price of the stock in early 1963 when that analysis was prepared was 992 per cent of the high 1953 price.[1] Three of the companies had no established market price in 1953, but the median appreciation for the remaining twenty-one companies was 472 per cent. This tremendous rise in the price of life insurance stocks has been a contributing factor in the attention currently being directed toward the financial reports of life insurance companies.

Underwriting and reserves

Accident and health insurance premiums comprised $31 million of the $66 million of premiums written by Company M in 1962. Of the life insurance in force at the end of 1962, group insurance comprised 16.6 per cent and ordinary insurance 83.4 per cent. Within the ordinary insurance category, term insurance comprised 46.4 per cent of the insurance in force on December 31, 1962. Consequently, a relatively small portion of premiums are held out of revenue to increase reserves.[2] The transfer to reserves is further restricted by the fact that most of the major plans now being

---

[1]See Appendix I.

[2]Approximately $10.3 million in 1962.

issued are valued on the Commissioners Reserve Valuation Method. The December 31, 1962, life insurance policy reserves were valued as follows:[1]

	Modal Interest Rate Assumption	Per Cent Of Total Reserves	Per Cent Of Reserve Plans Currently Used For New Business
Reserve valuation plans no longer used for new business:			
Net level premium	3 1/2%	13%	
Illinois Standard	3 1/2	28	
Reserve valuation plans currently used for new business:			
Net level premium	2 1/2	11	18%
Commissioners reserve valuation method (CRVM)	2 1/2	48	82
		100%	100%

A 3 per cent assumption is used under nearly all methods where the 1958 CSO mortality table is used (1961 and later). The total reserve under this 3 per cent assumption is now nearly as large as under the 2 1/2 per cent modal rate.

Procedures which illustrate nature of life insurance company financial reports

The examiner's report for 1959 discusses an accounting procedure which adds another illustration, similar to the handling of agents' balances, of a basic philosophy of insurance reporting. The following items were included in the Remittances and Items Not Allocated account at the end of 1959:

	Debit	Credit
Unallocated advances	$ 3,074.74	$10,831.99
Investment suspense		1,511.61
Policy loans		9,876.35
Ordinary premiums	181,907.38	
. . .	. . .	. . .
	$191,907.38	$40,299.05

---

[1]Includes life insurance reserves listed in Part A of Exhibit 8 of the Convention Blank only, without adjustment for reinsurance.

The $40,299.05 is included in liabilities in the examiner's report, but the debits of $191,907.38 are merged with bills receivable and eliminated as a non-admitted asset.[1] Thus, the examiners are careful to include every conceivable liability in the balance sheet, but only those assets which are specifically qualified as legal investments of insurance reserves. From an accounting viewpoint, both assets and surplus are understated in the Convention Blank so far as these items are concerned.

---

[1]The examiner's report makes several minor adjustments and reclassifications so this figure does not agree with that in the Group I adjustments in Schedule 1.

Life Insurance Company M
Adjustment of Gain from Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$ 3,210,568.12	$ 4,468,033.89	$ 4,345,820.27	$ 4,557,357.71	$ 4,630,876.97	$21,212,656.78
Items Entered Direct to Surplus on Convention Blank:						
Capital gains (losses) on assets sold	34,135.35	38,260.71	34,208.70	95,064.02	68,498.92	
Change in value of securities owned at end of year	(5,536.21)	(37,180.10)	(75,070.41)	30,414.77	107,135.03	
Change in value of non-admitted and related items	(70,537.77)	(198,066.18)	(22,393.83)	(182,119.51)	(231,425.34)	
Employees' retirement trust	99,127.46	-	-	-	-	
Net per Convention Blank before items classed as dispositions of income	$ 3,267,756.95	$ 4,271,048.32	$ 4,282,564.73	$ 4,500,716.99	$ 4,575,085.40	20,897,172.39
Adjustments (see accompanying schedules for detail):						
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 70,537.77	$ 198,066.18	$ 22,393.83	$ 182,119.51	$ 207,572.36	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	(22,828.50)	12,207.10	29,960.16	(76,891.91)	(148,334.10)	
Group III--Provide for possible losses on certain assets	(5,306.36)	(10,597.21)	(9,617.53)	(22,333.50)	(17,988.93)	
Group IV--Defer a portion of acquisition costs to future periods	134,023.39	209,000.04	233,237.16	184,538.08	184,244.47	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	28,706.74	1,646.24	96,709.37	48,646.44	211,230.25	
Total adjustments	$ 205,133.04	$ 410,322.35	$ 372,682.99	$ 316,078.62	$ 436,724.05	1,740,941.05
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ 3,472,889.99	$ 4,681,370.67	$ 4,655,247.72	$ 4,816,795.61	$ 5,011,809.45	22,638,113.44
Dispositions of Income:						
Transfers to appropriated surplus:						
Mandatory securities valuation reserve	$ 99,421.20	$ 73,709.34	$ 76,609.68	$ 200,872.67	$ 259,666.68	
Contingencies	(6,000,000.00)	-	-	-	-	
Reserve for annuity options	-	311,857.54	210,823.25	-	-	
Reserve strengthening	67,062.94	451,603.53	53,267.28	65,281.42	44,934.46	
Stock dividends to stockholders	-	-	-	2,000,000.00	2,000,000.00	
Cash dividends to stockholders	480,000.00	600,000.00	600,000.00	900,000.00	1,100,000.00	
Total dispositions of income	$(5,353,515.86)	$ 1,437,170.41	$ 940,700.21	$ 3,166,154.09	$ 3,404,601.14	
Net addition to (reduction of) unrestricted retained earnings	$ 8,826,405.85	$ 3,244,200.26	$ 3,714,547.51	$ 1,650,641.52	$ 1,607,208.31	
Beginning Unrestricted Retained Earnings	17,698,686.22	26,525,092.07	29,769,292.33	33,483,839.84	35,134,481.36	
Ending Unrestricted Retained Earnings	$26,525,092.07	$29,769,292.33	$33,483,839.84	$35,134,481.36	$36,741,689.67	
Ending Paid-in Surplus (net of commissions)	257,855.00	257,855.00	257,855.00	257,855.00	257,855.00	
Total	$26,782,949.07	$30,027,147.33	$33,741,694.84	$35,392,336.36	$36,999,544.67	
Ending Unassigned Surplus per Convention Blank	20,657,769.23	23,491,647.14	26,833,511.66	28,168,074.56	29,338,558.82	
Difference	$ 6,125,177.84	$ 6,535,500.19	$ 6,908,183.18	$ 7,224,261.80	$ 7,660,985.85	
Proof:						
Difference at beginning of period	$ 5,920,044.80	$ 6,125,177.84	$ 6,535,500.19	$ 6,908,183.18	$ 7,224,261.80	$ 5,920,044.80
Adjustments this year	205,133.04	410,322.35	372,682.99	316,078.62	436,724.05	1,740,941.05
Difference at end of period, as above	$ 6,122,177.84	$ 6,535,500.19	$ 6,908,183.18	$ 7,224,261.80	$ 7,660,985.85	$ 7,660,985.85

Life Insurance Company M
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 12-31-57	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):						
4. Agents' debit balances	$ 520,195.98	$ 53,063.63	$105,972.08	$ 96,175.29	$223,334.98	$ 179,889.32
7. Bills receivable	82,339.14	17,474.14	92,094.10	(73,781.46)	(41,215.47)	27,683.04
Total Group I adjustments	$ 602,535.12	$ 70,537.77	$198,066.18	$ 22,393.83	$182,119.51	$ 207,572.36
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:						
20. Bonds	$ -	$ 16,700.00	$ (9,169.09)	$ 15,826.16	$ (523.54)	$ (3,500.00)
21. Stocks	301,844.41	(36,163.79)	21,376.19	14,134.00	(76,368.37)	(144,901.33)
25. Change in capital gains as a result of other adjustments in this group	-	(3,364.71)	-	-	-	67.23
Total Group II adjustments	$ 301,844.41	$(22,828.50)	$ 12,207.10	$ 29,960.16	$(76,891.91)	$(148,334.10)
Group III--Provide for possible losses on certain assets:						
30. Agents' debit balances (estimated at 10%)	$ (52,019.60)	$ (5,306.36)	$(10,597.21)	$ (9,617.53)	$(22,333.50)	$ (17,988.93)
Group IV--Defer a portion of acquisition costs to future periods:						
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$4,224,925.61	$110,780.29	$214,927.27	$217,508.10	$192,987.03	$ 242,886.73
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	326,880.79	10,764.42	(3,496.80)	6,627.38	(7,385.77)	(49,184.74)
42. Accident and health insurance direct acquisition cost (deferred in same manner as Item 41)	97,151.34	12,478.68	(2,430.43)	9,101.68	(1,063.18)	(9,457.52)
Total Group IV adjustments	$4,648,957.74	$134,023.39	$209,000.04	$233,237.16	$184,538.08	$ 184,244.47
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:						
50. Record furniture and equipment	$ 827,646.16	$112,635.96	$ 87,632.45	$163,295.02	$148,201.80	$ 301,234.45
51. Record depreciation of furniture and equipment	(408,919.03)	(83,929.22)	(85,986.21)	(91,068.14)	(98,299.85)	(112,601.67)
54. Reverse placing value of furniture and equipment additions on the books by the company	-	-	-	-	-	23,852.98
59a. Capitalize permanent additions to buildings	-	-	-	25,110.25	-	-
59b. Depreciation of Item 59a	-	-	-	(627.76)	(1,255.51)	(1,255.51)
Total Group V adjustments	$ 418,727.13	$ 28,706.74	$ 1,646.24	$ 96,709.37	$ 48,646.44	$ 211,230.25
Total Adjustments	$5,920,044.80	$205,133.04	$410,322.35	$372,682.99	$316,078.62	$ 436,724.05

Company N

Company N was the forty-ninth largest life insurance company in the United States in 1962 in terms of admitted assets but moved to this position from fiftieth in 1961. It was selected because of this position. It is the twenty-third largest stock life insurance company.

Company N is wholly owned by a mutual insurance company. It sells only annual dividend life insurance, of which slightly over one-fourth is term insurance.[1] Full net level premium methods were used in valuing reserves on policies issued through 1947, but the Commissioners Reserve Valuation Method has been used on about eighty per cent of the policies issued since that date. However, a 2 1/2 per cent interest rate is assumed for all valuations whereas many companies value at least part of their policies under a higher interest rate assumption. Consequently, Company N currently allocates a slightly larger portion of premiums to reserves than firms which use a 3 per cent or higher interest assumption with preliminary term valuation methods.

All fixed assets are rented from the company which owns Company N. No adjustments regarding fixed assets are therefore required.

One new adjustment is listed in Schedule 1, but it is merely another example of non-admitted assets. This adjustment is given number "16" and involves under-remittances from branch offices. It is really a receivable.

[1]See Appendix I.

Life Insurance Company N
Adjustment of Gain from Operations and Changes in Surplus per Convention Blank To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$ 2,458,148.06	$ 2,775,362.88	$ 3,142,169.27	$ 3,395,218.28	$ 3,954,566.03	$15,725,464.52
Items Entered Direct to Surplus on Convention Blank:						
Capital gains (losses) on assets sold	(6,354.60)	4,029.85	4,857.11	7,720.90	(80,642.53)	
Change in value of securities owned at end of year	952,730.51	106,485.95	275,621.80	2,169,985.87	(1,286,062.36)	
Change in value of non-admitted and related items	(8,205.25)	(147,483.72)	(12,171.13)	50,975.40	(30,207.19)	
Adjustment of prior years' accounts	25,020.93	531,629.09	34,125.01	(13,416.87)	(29,870.11)	
Net per Convention Blank before items classed as dispositions of income	$ 3,421,339.65	$ 3,270,024.05	$ 3,444,602.06	$ 5,610,483.58	$ 2,527,783.84	18,274,233.18
Adjustments (see accompanying schedules for detail):						
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 10,547.70	$ 148,083.72	$ 12,971.13	$ (41,417.89)	$ 43,495.73	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	(955,072.96)	(107,085.95)	(276,421.80)	(2,179,543.38)	1,272,773.82	
Group IV--Defer a portion of acquisition costs to future periods	277,463.88	268,478.88	224,633.62	986,370.95	1,530,638.13	
Total adjustments	$ (667,061.38)	$ 309,476.65	$ (38,817.05)	$(1,232,590.32)	$ 2,846,907.68	1,217,915.58
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ 2,754,278.27	$ 3,579,500.70	$ 3,405,785.01	$ 4,377,893.26	$ 5,374,691.52	19,492,148.76
Dispositions of Income:						
Transfers to appropriated surplus accounts:						
Mandatory securities valuation reserve	$ 1,057,391.97	$ 242,197.66	$ 452,453.26	$ 2,398,003.83	$(1,158,435.22)	
Reserve for contingencies	(3,500,000.00)	-	-	-	-	
Reserve strengthening	36,460.35	(21,731.71)	134.88	694.35	1,798.43	
Dividends to stockholders	360,000.00	360,000.00	360,000.00	360,000.00	480,000.00	
Total dispositions of income	$(2,046,147.68)	$ 580,465.95	$ 812,588.14	$ 2,758,698.18	$ (676,636.79)	
Net addition to (reduction of) unrestricted retained earnings	$ 4,800,425.95	$ 2,999,034.75	$ 2,593,196.87	$ 1,619,195.08	$ 6,051,328.31	
Beginning Unrestricted Retained Earnings	15,334,278.77	20,134,704.72	23,133,739.47	25,726,936.34	27,346,131.42	
Ending Unrestricted Retained Earnings	$20,134,704.72	$23,133,739.47	$25,726,936.34	$27,346,131.42	$33,397,459.73	
Ending Paid-in Surplus	200,000.00	200,000.00	200,000.00	200,000.00	200,000.00	
Total	$20,334,704.72	$23,333,739.47	$25,926,936.34	$27,546,131.42	$33,597,459.73	
Ending Unassigned Surplus per Convention Blank	17,339,636.77	20,029,194.87	22,661,208.79	25,512,994.19	28,717,414.82	
Difference	$ 2,995,067.95	$ 3,304,544.60	$ 3,265,727.55	$ 2,033,137.23	$ 4,880,044.91	
Proof:						
Difference at beginning of year	$ 3,662,129.33	$ 2,995,067.95	$ 3,304,544.60	$ 3,265,727.55	$ 2,033,137.23	$ 3,662,129.33
Adjustments this year	(667,061.38)	309,476.65	(38,817.05)	(1,232,590.32)	2,846,907.68	1,217,915.58
Difference at end of year, as above	$ 2,995,067.95	$ 3,304,544.60	$ 3,265,727.55	$ 2,033,137.23	$ 4,880,044.91	$ 4,880,044.91

Life Insurance Company N
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 12-31-57	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):						
1. Supplies, stationery and printed matter	$ -	$ -	$ 136,272.60	$ 47,609.26	$ (57,323.02)	$ 18,010.78
2. Advances to agents or officers	100.00	300.00	(50.00)	(324.85)	(25.15)	200.00
4. Agents' debit balances	-	30.70	250.44	661.77	(612.92)	(184.63)
5. Premium notes, etc. in excess of net value and other policy liabilities on individual policies	157.55	2,342.45	600.00	800.00	900.00	1,000.00
7. Bills receivable	2,166.50	(1,043.74)	(147.91)	627.74	(656.96)	20,685.43
8. Foreign exchange	-	-	-	-	8,657.51	12,288.54
16. Underremittances	51,464.70	8,918.29	11,158.59	(36,402.79)	7,642.65	(8,504.39)
Total Group I adjustments	$ 53,888.75	$ 10,547.70	$ 148,083.72	$ 12,971.13	$ (41,417.89)	$ 43,495.73
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:						
20. Bonds	$ -	$ -	$ 249,040.96	$ (68,265.96)	$ (62,951.85)	$ (64,888.32)
21. Stocks	149,740.26	(955,072.96)	(356,126.91)	(208,155.84)	(2,116,591.53)	1,337,662.14
Total Group II adjustments	$ 149,740.26	$(955,072.96)	$(107,085.95)	$(276,421.80)	$(2,179,543.38)	$1,272,773.82
Group IV--Defer a portion of acquisition costs to future periods:						
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$3,458,500.32	$ 277,463.88	$ 268,478.88	$ 224,633.62	$ 988,370.95	$1,530,638.13
Total Adjustments	$3,662,129.33	$(667,061.38)	$ 309,476.65	$ (38,817.05)	$(1,232,590.32)	$2,846,907.68

Company O

Since the operations of Company N are comparatively simple, because they lease facilities from their parent company and write only ordinary life insurance, a second company of about the same size is also analyzed.

Underwriting and reserves

Repeated emphasis has been placed on the effect of the method of reserve valuation on the portion of premiums transferred to reserves and therefore on the reported income of life insurance companies. An attempt to compare the size of Companies N and O focuses attention on another significant factor which has been mentioned but not emphasized heretofore.

A substantial portion of the business written by Company O consists of types which require small reserves and consequently smaller admitted assets in proportion to insurance in force and premiums earned. As can be seen in Appendix I, individual ordinary life policies provided only a third of 1962 premiums. Furthermore, the amount of term insurance written was almost double whole life. As a result of these factors, even though the admitted assets of Company O are barely more than the admitted assets of Company N,[1] total premiums received during 1962 were approximately $72 million as compared to $51 million for Company N. Similarly, total life insurance in force for Company O at December 31, 1962, was $3.7 billion as compared to $2.2 billion for Company N.

Policy reserves on new issues are valued on the Commissioners Reserve Valuation Method with a 2 1/2 per cent interest assumption, but all the then outstanding policies were changed to the net level premium plan in 1959.

---

[1]$280 million for Company O; $272 million for Company N.

Procedures which illustrate nature of life insurance company financial reports

Several procedures are followed by Company O which demonstrate that the problems which were uncovered in the detailed analyses of domestic companies in the preceding chapter are not confined to those companies. The same types of conditions and problems seem to exist in some of the fifty largest companies also.

The first procedure discussed is best stated by verbatim quotation from the examiner's report for 1961, covering the years 1959, 1960 and 1961. Adjustment 56a in Schedule 1 should be noted in connection with this discussion.

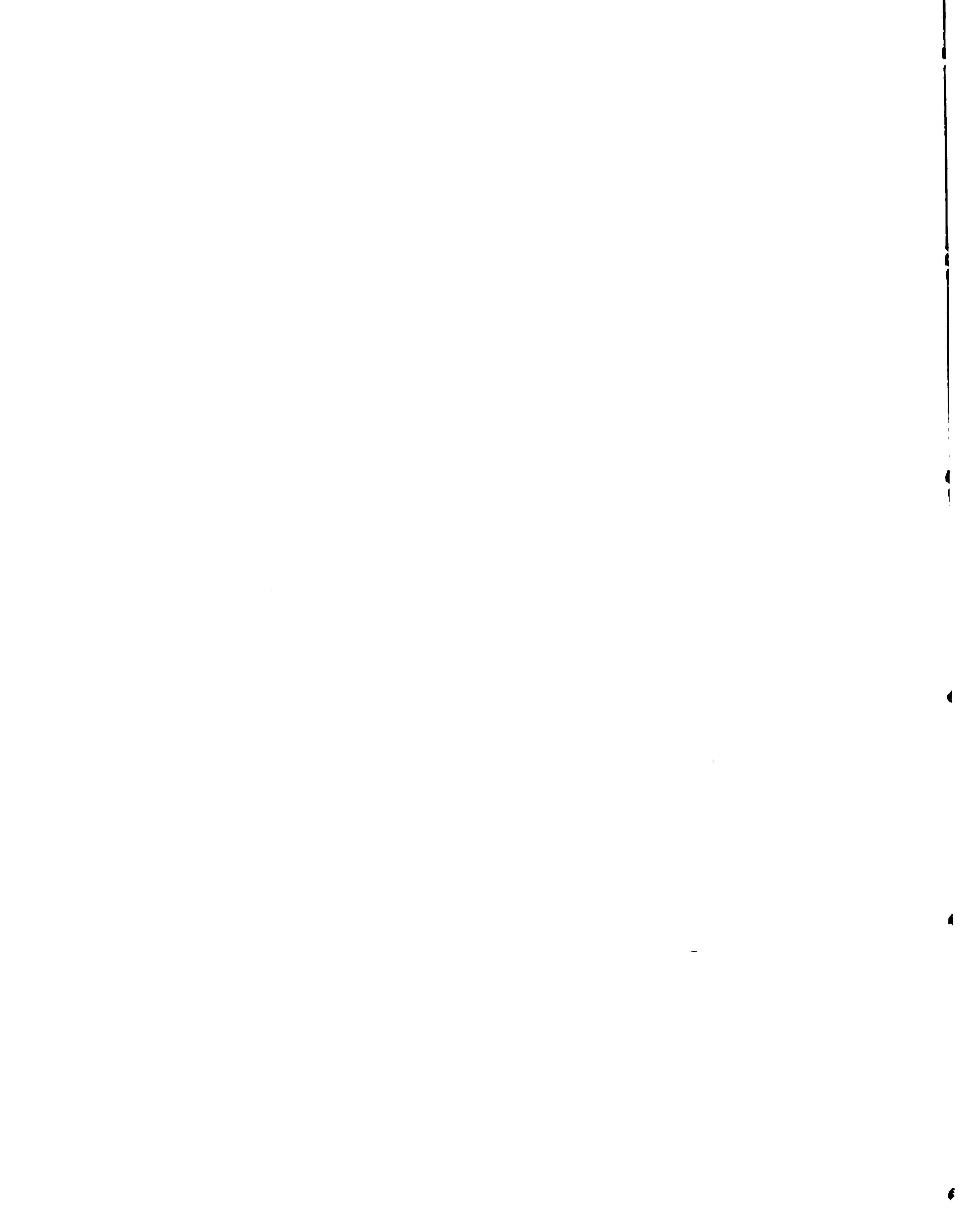
> The Company has followed the practice of decreasing the asset values of investment properties . . . by the excess of net income over a predetermined rate of income for each property each year. For the year 1961, predetermined percentages which were applied to previous year-end book values of the income producing properties . . . to determine the desired income were as follows:

Rate	3%	3.21%	4%	4.50%	4.75%	5.00%	6.00%	6.75%	7.25%	8.50%	25%
No. of parcels	2	1	12	4	2	8	1	2	1	1	1

> . . . .
>
> The established income determined from the percentages mentioned above for each property is deducted from the net income received for the year and the difference is the amount by which the book value of real estate is depreciated.
>
> The following schedule shows the net income from rentals, the predetermined income desired, and write down in book value, and the distribution of the write down on investment real estate, excluding the old home office property:

				Write Down Distribution Per Annual Statement[1]	
Year	Net Income Received	Less: Earned At Predetermined Rate of Income	Write Down in Book Value	Depreciation Reported In Exhibit of Net Investment Income	Decrease in Book Value, reported in Exhibit of Capital Gains and Losses on Investments
1959	$278,408.25	$144,607.95	$133,800.30	$75,795.38	$58,755.93
1960	343,469.44	177,770.64	165,698.80	87,094.90	78,787.49
1961	372,622.23	189,133.49	183,488.83	96,765.21	88,662.02

[1]Presumably these two columns do not contain adjustment on old home office.



If this procedure can be followed by one of the fifty largest companies and the examiner's report just summarize the procedure without direct criticism, the procedures which Company C once followed may be more typical of life insurance accounting than was assumed in the criticism of that company.

Both company procedure and the examiner's report reveal interesting attitudes toward treasury stock. Only one surplus account appears in the Convention Blank balance sheet, but Question 8A of the General Interrogatories asks for the "Total amount paid in by stockholders since organization of the company as surplus funds." The examiner's report reduces the amount reported by Company O in answer to that question by $31,275.21 because the company included the entire proceeds from the sale of treasury stock in their total. The examiners present the following tabulation[1] and comment in support of their revision:

					Effect On	
Year	Transaction	No. Sh.	Unit Price	Total Amount	Earned Surplus	Paid-in Surplus
1941	Acquired	7,002	$ 26.13	$182,974.82	$(182,974.82)	
1958	Sold	286.3	$ 85.00	$ 24,335.50	$ 7,481.02	$16,854.48
1959	Sold	575.45	105.50	60,709.97	15,036.51	45,673.46
1960	Stock split	6,140.25				
1961	Sold	670.06	57.50	38,528.45	8,757.68	29,770.77
Total dispositions				$123,573.92	$ 31,275.21	$92,298.71

> . . . The method of distributing the "price" of treasury stock transactions to "surplus earned" and "surplus paid-in" was on the basis of no ultimate effect on surplus earned . . . .

The interesting fact is that the remaining treasury shares are still included in capital stock outstanding.

A third procedure outlined in the examiner's report provides another example of the life insurance version of conservatism. The premiums on

---

[1]Subtotal added and arrangement slightly revised in order to emphasize the derivation of the $31,275.21.

loans acquired are charged off in the year in which the loans are acquired, whereas the discount on F. H. A. and V. A. loans is accrued over a period of five years, and the discount on conventional loans is not accrued until the time of liquidation of the loan.

Factors to note in the financial statements

Company O elected to change its reserves to the net level premium methods permissive for Federal income taxes in 1959. The comments made in the discussion of Company F are, therefore, also applicable to Company O.

Life Insurance Company O
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$ 3,658,638.03	$ 3,646,382.28	$ 4,267,469.15	$ 4,753,658.94	$ 3,518,810.31	$ 19,844,958.71
Items Entered Direct to Surplus in Convention Blank:						
Capital gains (losses) on assets sold	3,610.77	4,008.06	78,083.66	36,611.88	173,460.47	
Change in value of securities owned at end of year	4,978,158.36	1,820,709.25	417,306.36	7,538,542.89	(3,393,116.29)	
Change in value of non-admitted and related items	(136,881.07)	31,125.69	(106,870.89)	(90,524.81)	10,512.44	
Special income tax	-	(604,021.12)	57,778.80	(478,870.75)	-	
Other items	7,002.95	6,362.19	2,115.58	(141.78)	34,222.82	
Net per Convention Blank before items classed as dispositions of income	$ 8,510,529.04	$ 4,904,566.35	$ 4,714,882.66	$ 11,759,276.37	$ 343,889.75	30,233,144.17
Adjustments (see Schedule 1 for detail):						
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 135,686.20	$ (14,030.17)	$ 106,870.89	$ 104,676.16	$ (1,150.84)	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	(5,033,620.04)	(1,879,730.27)	(494,753.40)	(7,641,265.38)	3,318,814.48	
Group III--Provide for possible losses on certain assets	(12,635.09)	1,463.16	(9,363.45)	13,234.53	2,240.41	
Group IV--Defer a portion of acquisition costs to future periods	195,363.75	197,577.94	134,585.70	26,496.79	22,985.04	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	95,072.50	71,331.18	91,617.73	67,046.43	101,713.63	
Group VI--Transfer certain losses and expenses to the proper year	(604,021.12)	604,021.12	-	-	-	
Total adjustments	$(5,224,153.80)	$(1,019,367.04)	$ (171,042.53)	$ (7,429,811.47)	$ 3,444,602.72	(10,399,772.12)
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ 3,286,375.24	$ 3,885,199.31	$ 4,543,840.13	$ 4,329,464.90	$ 3,788,492.47	19,833,372.05
Dispositions of Income:						
Transfer to appropriated surplus accounts:						
Mandatory securities valuation reserve	$ 3,466,157.11	$ 530,931.80	$ 896,780.29	$ 5,433,461.41	$ (2,717,019.42)	
Market fluctuation reserve	1,641,909.85	(2,321,897.25)	-	-	-	
Other special reserves	830,783.07	(7,694,838.07)	-	-	-	
Change in loading on deferred premiums from reserve strengthening	-	(261,896.66)	-	(387,695.47)	-	
Reserve strengthening	29,710.36	6,983,768.84	15,777.20	2,110,666.59	23,690.67	
Stock dividends to stockholders	-	739,477.50	-	814,000.70	895,735.80	
Cash dividends to stockholders	1,730,594.14	1,165,108.66	1,261,701.09	1,367,789.20	1,504,966.84	
Total dispositions of income	$ 7,699,154.53	$ (859,345.18)	$ 2,174,258.58	$ 9,338,222.43	$ (292,626.11)	
Net addition to (reduction of) unrestricted retained earnings	$(4,412,779.29)	$ 4,744,544.49	$ 2,369,581.55	$ (5,008,757.53)	$ 4,081,118.58	
Beginning Unrestricted Retained Earnings	10,031,268.86	5,618,489.57	10,363,034.06	12,732,615.61	7,723,858.08	
Ending Unrestricted Retained Earnings	$ 5,618,489.57	$10,363,034.06	$12,732,615.61	$ 7,723,858.08	$ 11,804,976.66	
Ending Paid-in Surplus (net of commissions) less Treasury stock	2,251,030.85	2,311,740.82	2,311,740.82	2,350,269.27	2,350,269.27	
Total	$ 7,869,520.42	$12,674,774.88	$15,044,356.43	$ 10,074,127.35	$ 14,155,245.93	
Ending Unassigned Surplus per Convention Blank	13,268,605.73	19,093,227.23	21,633,851.31	24,093,433.70	24,729,949.56	
Difference	$(5,399,085.31)	$(6,418,452.35)	$(6,589,494.88)	$(14,019,306.35)	$(10,574,703.63)	
Proof:						
Difference at beginning of year	$ (174,931.51)	$(5,399,085.31)	$(6,418,452.35)	$ (6,589,494.88)	$(14,019,306.35)	$ (174,931.51)
Adjustments this year	(5,224,153.80)	(1,019,367.04)	(171,042.53)	(7,429,811.47)	3,444,602.72	(10,399,772.12)
Difference at end of year, as above	$(5,399,085.31)	$(6,418,452.35)	$(6,589,494.88)	$(14,019,306.35)	$(10,574,703.63)	$(10,574,703.63)

Life Insurance Company O
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 12-31-57	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):						
2. Advances to agents or officers	$ 439.63	$ (224.20)	$ 209.21	$ 782.69	$ 196,907.14	$ 10,716.95
4. Agents' debit balances	406,143.82	126,350.89	(14,631.57)	93,634.47	(132,345.28)	(22,404.06)
5. Policy loans, etc. in excess of net value and other policy liabilities on individual policies	5,000.00	-	-	-	-	-
7. Bills receivable	11,187.70	7,161.34	(1,314.83)	4,833.11	33,665.33	1,308.22
8. Foreign exchange	-	-	-	-	14,151.35	9,361.60
10. Miscellaneous debits	4,627.63	2,398.17	1,707.02	7,620.62	(7,702.38)	(133.55)
Total Group I adjustments	$ 427,398.78	$ 135,686.20	$ (14,030.17)	$ 106,870.89	$ 104,676.16	$ (1,150.84)
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:						
20. Bonds	$ -	$ -	$ -	$ 9,375.00	$ -	$ -
21. Stocks	(2,863,684.09)	(5,033,620.04)	(1,879,730.27)	(504,128.40)	(7,641,265.38)	3,318,814.48
Total Group II adjustments	$(2,863,684.09)	$(5,033,620.04)	$(1,879,730.27)	$(494,753.40)	$(7,641,265.38)	$3,318,814.48
Group III--Provide for possible losses on certain assets:						
30. Agents' debit balances (estimated at 10%)	$ (40,614.38)	$ (12,635.09)	$ 1,463.16	$ (9,363.45)	$ 13,234.53	$ 2,240.41
Group IV--Defer a portion of acquisition costs to future periods:						
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$ 1,911,128.52	$ 190,933.49	$ 197,309.11	$ 141,341.13	$ 22,983.22	$ 20,557.46
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve	21,484.30	4,559.07	123.90	(6,862.66)	2,584.34	(378.93)
42. Accident and health insurance direct acquisition cost (deferred in same manner as Item 41)	7,599.00	(128.81)	144.93	107.23	929.23	2,806.51
Total Group IV adjustments	$ 1,940,211.82	$ 195,363.75	$ 197,577.94	$ 134,585.70	$ 26,496.79	$ 22,985.04
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:						
50. Record furniture and fixtures	$ 602,784.40	$ 104,171.14	$ 82,754.06	$ 86,131.81	$ 52,387.80	$ 80,862.74
51. Record depreciation of furniture and fixtures	(241,028.04)	(64,232.66)	(70,178.81)	(73,301.57)	(74,003.39)	(89,557.27)
56a. Reverse company's write down of building in excess of depreciation in Exhibit 2 of Convention Blank	-	55,134.02	58,755.93	78,787.49	88,662.02	110,408.16
Total Group V adjustments	$ 361,756.36	$ 95,072.50	$ 71,331.18	$ 91,617.73	$ 67,046.43	$ 101,713.63
Group VI--Transfer certain losses and expenses to the proper year:						
60. Retroactive income tax on 1958 income	$ -	$ (604,021.12)	$ 604,021.12	$ -	$ -	$ -
Total Adjustments	$ (174,931.51)	$(5,224,153.80)	$(1,019,367.04)	$(171,042.53)	$(7,429,811.47)	$3,444,602.72

Company P

Company P was selected for two reasons. Most important, it has the smallest percentage increase in premium income during the ten years 1952-1962 of any of the twenty-four firms analyzed in the First Boston Corporation's analysis. It thus provides an opportunity to test the hypothesis that the adjustments should make little change in annual income in a firm whose volume is steady. Most life insurance companies have expanded rapidly during the past ten-year period, so it is hard to find sound companies which have maintained about the same volume of premiums. Company P had only a 27 per cent increase over the ten-year period. The median increase for the twenty-four companies is 114 per cent.

The second reason for selecting the firm was to further test the hypothesis suggested in the discussion of Company O that when two firms have about the same amount of admitted assets but one has less life insurance in force, it is safe to assume that it writes a larger portion of ordinary life and endowment policies and fewer term, group and accident and health policies. In this instance, the admitted assets of Company P are nearly the same as those of Company F, but Company P has $1.5 billion of insurance in force compared to $2.9 billion for Company F.

Reference to Appendix I will quickly show that the second hypothesis holds in this instance. Company P writes no accident and health insurance, group insurance is negligible and term policies represent less than one-fifth of the insurance in force. Furthermore, net level premium methods are used in the valuation of some of the reserves. The December 31, 1962, policy reserves were valued as follows:

	Modal Interest Rate Assumption	Per Cent Of	
		Total Reserves	Reserve Plans Currently Used For New Business
Reserve valuation plans no longer used for new business:			
Net level premium plan	3 1/2%	31%	
New Jersey Standard	3	32	
Reserve valuation plans currently used for new business:			
Net level premium plan	3	14	38%
Commissioners reserve valuation method (CRVM)	3	23	62
		100%	100%

Schedule 1 demonstrates that the first hypothesis also holds to a remarkable degree for Company P. The net adjustment for the five-year period is less than $100,000 against net income of over $21 million.

Evaluation of the analysis of Company P should be preceded by recognition that this company has not only concentrated on the older traditional types of insurance (on a profitable basis, since premiums are only $34 million in 1962) but has refrained from investing in common stocks at all and has held its investment in preferred stocks to less than one per cent of admitted assets. Mortgage loans, by contrast, comprise nearly 45 per cent of admitted assets.

Life Insurance Company P
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$ 3,838,062.45	$ 4,083,154.96	$ 4,549,038.43	$ 4,105,262.69	$ 4,569,511.03	$21,145,029.56
Items Entered Direct to Surplus on Convention Blank:						
Capital gains (losses) on assets sold	159,686.75	7,675.14	59,978.28	102,699.38	126,783.65	
Change in value of assets owned at end of year	(156,306.44)	(27,649.58)	(67,799.08)	33,949.35	117,515.98	
Change in value of non-admitted and related items	17,281.02	(34,585.61)	16,128.94	(274,096.77)	(50,056.59)	
Amortization of premium and discount on mortgage loans	(36,630.34)	(145,013.23)	2,516.45	97,292.72	97,408.51	
Additional 1958 Federal income tax	-	-	(200,000.00)	-	-	
Net per Convention Blank before items classed as dispositions of income	$ 3,822,093.44	$ 3,883,581.68	$ 4,359,863.02	$ 4,065,107.37	$ 4,861,162.58	20,991,808.09
Adjustments (see Schedule 1 for detail):						
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ (16,007.29)	$ 34,585.61	$ (16,128.94)	$ 48,626.49	$ 59,056.59	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	26,507.49	27,645.58	61,800.08	(24,949.35)	(126,515.98)	
Group III--Provide for possible losses on certain assets	1,758.68	(3,253.13)	470.91	(5,334.32)	5,735.35	
Group IV--Defer a portion of acquisition costs to future periods	126,933.41	56,445.34	(35,599.32)	(41,535.55)	(153,131.46)	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	81,712.41	(13,046.03)	(13,785.20)	227,165.98	(215,205.95)	
Group VI--Transfer certain losses and expenses to the proper year	(200,000.00)	-	200,000.00	-	-	
Total adjustments	$ 20,904.70	$ 102,377.37	$ 196,757.53	$ 203,973.25	$ (430,061.45)	93,951.40
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ 3,842,998.14	$ 3,985,959.05	$ 4,556,620.55	$ 4,269,080.62	$ 4,431,101.13	21,085,759.49
Dispositions of Income:						
Transfer to appropriated surplus accounts:						
Mandatory securities valuation reserve	$ 158,203.24	$ 157,500.00	$ 145,000.00	$ 200,000.00	$ 280,000.00	
Other investment loss reserve	-	-	370,000.00	(370,000.00)	-	
Reserve strengthening	103,269.00	1,286,218.00	97,758.00	76,588.00	84,711.00	
Dividends to stockholders	320,000.00	400,000.00	400,000.00	560,000.00	560,000.00	
Total dispositions of income	$ 581,472.24	$ 1,843,718.00	$ 1,012,758.00	$ 466,588.00	$ 924,711.00	
Net addition to (reduction of) unrestricted retained earnings	$ 3,261,525.90	$ 2,142,241.05	$ 3,543,862.55	$ 3,802,492.62	$ 3,506,390.13	
Beginning Unrestricted Retained Earnings	30,920,269.14	34,181,795.04	36,324,036.09	39,867,898.64	43,670,391.26	
Ending Unrestricted Retained Earnings	$34,181,795.04	$36,324,036.09	$39,867,898.64	$43,670,391.26	$47,176,781.39	
Ending Unassigned Surplus per Convention Blank	28,448,171.94	30,488,035.62	33,835,140.64	37,433,660.01	41,370,111.59	
Difference	$ 5,733,623.10	$ 5,836,000.47	$ 6,032,758.00	$ 6,236,731.25	$ 5,806,669.80	
Proof:						
Difference at beginning of year	$ 5,712,718.40	$ 5,733,623.10	$ 5,836,000.47	$ 6,032,758.00	$ 6,236,731.25	$ 5,712,718.40
Adjustments this year	20,904.70	102,377.37	196,757.53	203,973.25	(430,061.45)	93,951.40
Difference at end of year, as above	$ 5,733,623.10	$ 5,836,000.47	$ 6,032,758.00	$ 6,236,731.25	$ 5,806,669.80	$ 5,806,669.80

Life Insurance Company P
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 12-31-57	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):						
2. Advances to agents or officers	$ 13,132.42	$ 323.73	$ 2,083.31	$ (5,418.81)	$ 4,274.26	$ (7,319.91)
4. Agents' debit balances	264,919.08	(17,586.75)	32,531.30	(4,709.13)	53,343.23	57,353.50
5. Policy loans, etc. in excess of net value and other policy liabilities on individual policies	10,000.00	-	-	-	(9,000.00)	9,000.00
7. Bills receivable	6,127.00	(18.00)	(29.00)	(6,001.00)	9.00	23.00
10. Miscellaneous debits	9,330.90	1,273.73	-	-	-	-
Total Group I adjustments	$ 303,509.40	$ (16,007.29)	$ 34,585.61	$(16,128.94)	$ 48,626.49	$ 59,056.59
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:						
20. Bonds	$ -	$ -	$ -	$ 53,000.00	$ -	$ (25,000.00)
21. Stocks (all preferred)	584,725.90	26,507.49	27,645.58	8,800.08	(24,949.35)	(101,515.98)
Total Group II adjustments	$ 584,725.90	$ 26,507.49	$ 27,645.58	$ 61,800.08	$(24,949.35)	$(126,515.98)
Group III--Provide for possible losses on certain assets:						
30. Agents' debit balances (estimated at 10%)	$ (26,491.91)	$ 1,758.68	$ (3,253.13)	$ 470.91	$ (5,334.32)	$ 5,735.35
Group IV--Defer a portion of acquisition costs to future periods:						
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$4,384,513.10	$ 126,933.41	$ 56,445.34	$(35,599.32)	$(41,535.55)	$(153,131.46)
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:						
50. Record furniture and equipment	$ 759,521.61	$ 163,560.77	$ 75,889.57	$ 77,157.86	$102,722.24	$ 97,752.21
51. Record depreciation of furniture and equipment	(293,059.70)	(81,848.36)	(88,935.60)	(90,943.06)	(92,026.54)	(96,487.88)
54. Reverse placing of value of furniture and equipment on the books by the company	-	-	-	-	216,470.28	(216,470.28)
Total Group V adjustments	$ 466,461.91	$ 81,712.41	$(13,046.03)	$(13,785.20)	$227,165.98	$(215,205.95)
Group VI--Transfer certain losses and expenses to the proper year:						
60. Retroactive 1958 Federal income tax	$ -	$(200,000.00)	$ -	$200,000.00	$ -	$ -
Total Adjustments	$5,712,718.40	$ 20,904.70	$102,377.37	$196,757.53	$203,973.25	$(430,061.45)

Company Q

Company Q is the representative of companies with admitted assets of about $750 million, thus providing a test intermediary between Company P which has slightly less than $500 million of admitted assets and Companies R and S with approximately $1 billion each. Preparation of Appendix I immediately revealed that Company Q falls into the category of firms which have concentrated on ordinary insurance. It is the largest stock company which sells only ordinary life insurance and annuities. However, unlike Company P which has maintained relatively stable volume during the analysis period, Company Q achieved a typical expansion.[1] One would, therefore, expect the adjustments to have considerably more effect on the earnings of Company Q than of Company P, if the tentative conclusions of the previous analyses are sound. Reference to Exhibit A shows that this is only partly true. Total adjustments during the five-year period are $1.2 million against a Convention Blank operating gain of $61.6 million, and a gain of $62.6 million after considering items charged direct to surplus. This is significant in comparison to total adjustments of less than $100,000 for Company P, but is still only a two per cent change. It should be noted, however, that Company Q has only 0.3% of its assets invested in stocks. The Group II adjustments are, therefore, insignificant whereas they comprise the largest group for many of the companies.

Even though the adjustments do not have a major effect on total earnings for the five-year analysis period, the cumulative adjustment to surplus is over $22 million against an unassigned legal surplus of $38 million.

---

[1]The increase in premiums during the ten-year period shown on the fourth line of Appendix I is 127% compared to a median increase for the twenty-four companies in the First Boston Corporation analysis of 114%.

Other factors which must be kept in mind in evaluating the significance of the adjustments are that nearly half of the business written in 1962 was term insurance, that the Commissioners Reserve Valuation Method is used in valuing most of the currently issued policies, and that no group insurance is written. The December 31, 1962, life insurance policy reserves were valued as follows:

	Modal Interest Rate Assumption	Per Cent Of Total Reserves	Per Cent Of Reserve Plans Currently Used For New Business
Reserve valuation plans no longer used for new business:			
Net level premium plan	3 1/2%	16%	
New Jersey Standard plan	3	12	
Reserve valuation plans currently used for new business:			
Net level premium plan	3	6	8%
Commissioners reserve valuation method (CRVM)	3	60	84
New Jersey Standard plan	2 1/2	6	8
		100%	100%

Life Insurance Company Q
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance with "Generally Accepted Accounting Principles"

Exhibit A

	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$10,310,955.18	$10,162,771.65	$12,507,675.43	$13,589,152.34	$15,037,838.24	$61,608,392.84
Items Entered Direct to Surplus on Convention Blank:						
Capital gains (losses) on assets sold	206,855.40	(2,924.79)	(18,611.87)	51,805.55	234,318.67	
Change in value of assets owned at end of year	219,683.60	156,778.18	138,591.57	53,163.34	278,152.40	
Change in value of non-admitted and related items	(124,516.91)	926,263.41	(212,345.55)	127,102.34	(17,589.58)	
Retroactive 1958 Federal income tax	-	(1,059,857.80)	-	-	-	
Other	143.34	(37.27)	(444.77)	(4,922.47)	(3,935.90)	
Net per Convention Blank before items classed as dispositions of income	$10,613,120.61	$10,182,993.38	$12,414,864.81	$13,816,301.10	$15,528,783.83	62,556,063.73
Adjustments (see Schedule 1 for detail):						
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 132,498.70	$ 12,264.79	$ 211,932.70	$ (127,466.02)	$ 10,040.09	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	(228,115.39)	(156,271.76)	(138,178.72)	(114,549.66)	(281,126.91)	
Group III--Provide for possible losses on certain assets	(12,451.69)	(1,277.12)	(21,234.56)	12,710.23	(1,758.96)	
Group IV--Defer a portion of acquisition costs to future periods	297,028.73	1,142,104.60	600,458.29	406,544.16	362,259.04	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	105,158.72	(914,278.95)	(57,459.12)	(22,022.74)	(84,479.75)	
Group VI--Transfer certain losses and expenses to the proper year and correct minor errors	(1,059,857.80)	1,059,857.80	-	61,750.00	5,988.00	
Total Adjustments	$ (765,738.73)	$ 1,142,399.36	$ 595,518.59	$ 216,965.97	$ 10,921.51	1,200,066.70
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ 9,847,381.88	$11,325,392.74	$13,010,383.40	$14,033,267.07	$15,539,705.34	63,756,130.43
Dispositions of Income:						
Transfer to appropriated surplus accounts:						
Mandatory securities valuation reserve	$ 295,073.12	$ 111,112.93	$ 142,867.65	$ 308,014.10	$ 224,492.79	
Reserve strengthening	157,110.00	128,023.00	93,754.00	77,253.00	88,620.00	
Dividends to stockholders	2,341,406.24	3,482,841.70	2,929,687.16	7,098,852.00	3,846,959.51	
Total dispositions of income	$ 2,793,589.36	$ 3,721,977.63	$ 3,166,308.81	$ 7,484,119.10	$ 4,160,072.30	
Net addition to (reduction of) unrestricted retained earnings	$ 7,053,792.52	$ 7,603,415.11	$ 9,844,074.59	$ 6,549,147.97	$11,379,633.04	
Beginning Unrestricted Retained Earnings	52,035,299.06	59,089,091.58	66,692,506.69	76,536,581.28	83,085,729.25	
Ending Unrestricted Retained Earnings	$59,089,091.58	$66,692,506.69	$76,536,581.28	$83,085,729.25	$94,465,362.29	
Ending Paid-in Surplus (net of commissions)	800,000.00	800,000.00	800,000.00	979,250.00	1,156,098.47	
Total	$59,889,091.58	$67,492,506.69	$77,336,581.28	$84,064,979.25	$95,621,460.76	
Ending Unassigned Surplus per Convention Blank	38,360,156.25	44,821,172.00	54,069,728.00	60,581,160.00	72,126,720.00	
Difference	$21,528,935.33	$22,671,334.69	$23,266,853.28	$23,483,819.25	$23,494,740.76	
Proof:						
Difference at beginning of year	$22,294,674.06	$21,528,935.33	$22,671,334.69	$23,266,853.28	$23,483,819.25	$22,294,674.06
Adjustments this year	(765,738.73)	1,142,399.36	595,518.59	216,965.97	10,921.51	1,200,066.70
Difference at end of year, as above	$21,528,935.33	$22,671,334.69	$23,266,853.28	$23,483,819.25	$23,494,740.76	$23,494,740.76

Life Insurance Company Q
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 12-31-57	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):						
4. Agents' debit balances	$ 417,161.10	$ 124,516.91	$ 12,771.21	$ 212,345.55	$(127,102.34)	$ 17,589.58
5. Premium notes, etc. in excess of net value and other policy liabilities on individual policies	5,000.00	-	-	-	-	-
17. Real estate	2,175.81	7,981.79	(506.42)	(412.85)	(363.68)	(7,549.49)
Total Group I adjustments	$ 424,336.91	$ 132,498.70	$ 12,264.79	$ 211,932.70	$(127,466.02)	$ 10,040.09
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:						
20. Bonds	$ 25,932.01	$ (10,666.00)	$ 12,168.82	$ (1,438.27)	$ (25,996.56)	$ -
21. Stocks	11,251.00	(210.00)	1,152.00	81.60	(534.72)	(281,126.91)
22. Mortgage loans	344,444.37	(217,239.39)	(169,592.58)	(136,822.05)	(88,018.38)	-
Total Group II adjustments	$ 381,627.38	$ (228,115.39)	$ (156,271.76)	$(138,178.72)	$(114,549.66)	$(281,126.91)
Group III--Provide for possible losses on certain assets: Agents' debit balances (estimated at 10%)	$ (41,716.11)	$ (12,451.69)	$ (1,277.12)	$ (21,234.56)	$ 12,710.23	$ (1,758.96)
Group IV--Defer a portion of acquisition costs to future periods:						
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$19,928,209.30	$ 297,028.73	$ 1,142,104.60	$ 600,458.29	$ 406,544.16	$ 362,259.04
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:						
50. Record furniture and equipment	$ 1,435,085.93	$ 325,879.24	$ 158,054.39	$ 111,552.40	$ 147,154.34	$ 85,016.10
51. Record depreciation of furniture and equipment	(719,364.59)	(203,784.07)	(202,774.55)	(169,011.52)	(169,177.08)	(169,495.85)
50a. Record electronic data processing equipment	1,132,460.68	114,730.22	69,475.83	-	-	-
51a. Record depreciation of electronic data processing			(1,316,666.73)			
equipment	(245,965.44)	(131,666.67)	377,632.11	-	-	-
Total Group V adjustments	$ 1,602,216.58	$ 105,158.72	$ (914,278.95)	$ (57,459.12)	$ (22,022.74)	$ (84,479.75)
Group VI--Transfer certain losses and expenses to the proper year and correct minor errors:						
60. Retroactive Federal income tax on 1958 income	$ -	$(1,059,857.80)	$ 1,059,857.80	$ -	$ -	$ -
66. Transfer Treasury stock to a negative capital account	-	-	-	-	61,750.00	5,988.00
Total Group VI adjustments	$ -	$(1,059,857.80)	$ 1,059,857.80	$ -	$ 61,750.00	$ 5,988.00
Total Adjustments	$22,294,674.06	$ (765,738.73)	$ 1,142,399.36	$ 595,518.59	$ 216,965.97	$ 10,921.51

Company R

Company S was originally selected as the firm to follow Company Q because it is the stock company with admitted assets closest to $1 billion, as tabulated in the Fortune Directory. However, it was later noted that Company R has one-eighth of its admitted assets in the form of stocks. This is the second highest portion among the twenty-four companies included in the First Boston Corporation's analysis, the highest being Company O. Since Company R is approximately three times the size of Company O in terms of admitted assets, it seemed appropriate to include an analysis of Company R in this study even though it is nearly the same size as Company S.

This decision proved wise because several interesting features were found in the reports of Company R which add to the understanding of life insurance company financial reporting.

Underwriting and reserves

As can be seen in Appendix I, Company R is the first firm analyzed which writes a substantial amount of industrial insurance. Group and accident and health insurance are also important sources of revenue.

The reserves on a few current policies are valued on the Commissioners Reserve Valuation Method, but most are on the net level premium plan. The Convention Blank prepared by Company R does not show the years during which policies were issued under each valuation plan, but the composition of the total reserve at December 31, 1962, was:

Reserve valuation plan	Modal Interest Rate Assumption	Per Cent Of Total Reserve
Net level premium plan	2 3/4%	90%
Commissioners reserve valuation method	2 3/4	5
Illinois standard plan	3 1/2	5
New Jersey standard plan	3 1/2	-
		100%

It appears that all except a few special policies are valued on the net level premium plan. These special policies were apparently once valued on the Illinois standard plan using the American Experience mortality table, but new business for these policies now use the CSO mortality tables under the Commissioners Reserve Valuation Method.

Procedures which illustrate nature of life insurance company financial reports

Stock dividends on stock owned.--The examiner's report at December 31, 1961, notes that shares received as stock dividends are recorded at $1.00. Consequently, shares having a total market value of $20,763,842.76 on December 31, 1961, were carried at a book value of $33.00. This book value is adjusted to market value each time a Convention Blank is prepared through the use of the "non-ledger" technique in Exhibit 13 of the blank.

Accrued interest past due.--The examiner's report reveals that $10,272.38 of past due interest and interest on securities which do not meet the qualifications for admitted assets is treated as a non-admitted asset. This information is reflected in Exhibit 13 of the Convention Blank, but is not shown in reports to stockholders which are restricted to the statements on pages 2, 3 and 4 of the blank. Even though the amount is small in this firm, it might be significant in other instances, so should be set forth in order to show that such loans have been made. Unless this is done, a complete report of accountability is not made. Naturally, this item would be combined with other factors in condensed statements, but should be shown whenever detailed statements are presented.

Depreciation of electronic data processing equipment.--The examiner's report points out that depreciation on this equipment is "computed on the basis of a two shift rental cost, as though the equipment had been rented

instead of purchased." Here again is an example of the philosophy that almost anything that is immediately conservative is acceptable.

Generally accepted accounting requires that the facts be reported, not what the facts would be if something else had been done. If equipment is owned, the cost of owning the asset must be depreciated over the useful life of the asset if the statements are to properly bear the label "generally accepted."

The procedure adopted by Company R reflects a false sense of need for comparability. Analytical comparisons of "what might have been" with what this or some other company actually does are often extremely valuable, but they should be treated as supplemental analyses. The formal accounting records and primary reports should be restricted to what actually did happen.

Adjustments not previously discussed

Inasmuch as the installment method of reporting profit on sale of assets is followed by some firms whose statements are given the generally accepted label by their independent public accountants, there is some question whether Adjustment 23 is necessary. It is made, however, in order to focus attention on certain aspects of life insurance accounting and because the statements are clearly acceptable with the adjustment whereas there is room for argument if it is not made.

Certain real estate was sold in 1958 at a profit of $1,276,464.80, but mortgage notes were accepted for most of the price. The profit is reported by the company as a realized capital gain, but the unrealized profit is considered a mortgage note not admitted. The final result is that the profit is added to surplus on the installment basis.

Interestingly, the examiner's report at December 31, 1961, includes the portion not realized at that time ($489,069.82) as a liability instead of a non-admitted asset as is done in the Convention Blank by the company. The examiners do not explain what makes the item a liability. Perhaps it is merely a matter of convenience since the account has a credit balance.

Life Insurance Company R
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$ 13,312,219.51	$ 9,742,332.87	$ 11,574,939.76	$ 12,865,952.10	$ 17,190,124.23	$ 64,685,568.47
Items Entered Direct to Surplus on Convention Blank:						
Capital gains (losses) on assets sold	3,997,411.48	171,070.64	16,659,573.35	8,216,188.55	5,927,634.94	
Change in value of assets owned at end of year	30,507,153.19	10,392,748.37	(16,903,713.30)	18,669,658.70	(17,547,495.15)	
Change in value of non-admitted and related items	(1,565,569.86)	(220,458.46)	(660,398.46)	(1,031,879.76)	(720,538.75)	
Other	25,674.71	10,637.89	(1,290,033.98)	5,883.70	11,313.37	
Net per Convention Blank before items classed as dispositions of income	$ 46,276,889.03	$ 20,096,331.31	$ 9,380,367.37	$ 38,725,803.29	$ 4,861,038.64	119,340,429.64
Adjustments (see Schedule 1 for detail):						
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 621,502.50	$ 786,035.30	$ 1,308,082.62	$ 1,260,910.61	$ 673,510.96	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	(29,480,483.27)	(10,429,079.88)	16,666,406.13	(19,076,284.39)	17,567,743.48	
Group III--Provide for possible losses on certain assets	(62,102.29)	(78,207.87)	(129,093.38)	(126,109.86)	(67,251.00)	
Group IV--Defer a portion of acquisition costs to future periods	2,442,201.49	3,375,607.24	3,207,428.50	2,398,831.07	2,084,793.68	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at amortized cost	495,309.44	306,407.78	232,576.33	261,945.68	399,758.66	
Group VI--Transfer certain losses and expenses to the proper year	-	-	1,170,000.00	(130,000.00)	(130,000.00)	
Total adjustments	$(25,983,572.13)	$ (6,039,237.43)	$ 22,455,400.20	$(15,410,706.89)	$ 20,528,555.78	(4,449,560.47)
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ 20,293,316.90	$ 14,057,093.88	$ 31,835,767.57	$ 23,315,096.40	$ 25,389,594.42	114,890,869.17
Dispositions of Income:						
Transfer to appropriated surplus accounts:						
Mandatory securities valuation reserve	$ 18,646,031.20	$ 3,559,215.00	$ (7,407,773.00)	$ 3,831,748.00	$ (3,140,168.64)	
Voluntary securities valuation reserve	11,861,109.29	(1,090,599.46)	(9,487,114.35)	14,703,502.13	(47,736,110.70)	
Special reserve	-	-	-	-	33,181,890.00	
Reserve strengthening and adjustments	806,180.00	8,688,438.00	731,491.00	3,868,224.00	(1,714,895.00)	
Change in deferred premiums due to reserves released	-	(804,820.87)	-	-	-	
Transfer to deferred liability under agency contracts and Federal income tax	-	-	-	-	5,400,000.00	
Stock dividends	3,000,000.00	-	-	-	-	
Cash dividends	3,780,000.00	4,290,000.00	5,280,000.00	6,599,960.44	6,930,000.00	
Total dispositions of income	$ 38,093,320.49	$ 14,642,232.67	$(10,883,396.35)	$ 29,003,434.57	$ (7,079,284.34)	
Net addition to (reduction of) unrestricted retained earnings	$(17,800,003.59)	$ (585,138.79)	$ 42,719,163.92	$ (5,688,338.17)	$ 32,468,878.76	
Beginning Unrestricted Retained Earnings	29,032,046.21	11,232,042.62	10,646,903.83	53,366,067.75	47,677,729.58	
Ending Unrestricted Retained Earnings	$ 11,232,042.62	$ 10,646,903.83	$ 53,366,067.75	$ 47,677,729.58	$ 80,146,608.34	
Ending Paid-in Surplus	200,000.00	200,000.00	200,000.00	200,000.00	200,000.00	
Total	$ 11,432,042.62	$ 10,846,903.83	$ 53,566,067.75	$ 47,877,729.58	$ 80,346.608.34	
Ending Unassigned Surplus per Convention Blank	60,608,978.98	66,063,077.62	86,326,841.34	96,049,210.06	107,989,533.04	
Difference	$(49,176,936.36)	$(55,216,173.79)	$(32,760,773.59)	$(48,171,480.48)	$(27,642,924.70)	
Proof:						
Difference at beginning of year	$(23,193,364.23)	$(49,176,936.36)	$(55,216,173.79)	$(32,760,773.59)	$(48,171,480.48)	$(23,193,364.23)
Adjustments this year	(25,983,572.13)	(6,039,237.43)	22,455,400.20	(15,410,706.89)	20,528,555.78	(4,449,560.47)
Difference at end of year	$(49,176,936.36)	$(55,216,173.79)	$(32,760,773.59)	$(48,171,480.48)	$(27,642,924.70)	$(27,642,924.70)

Life Insurance Company R
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 12-31-57	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):						
3. Loans considered inadmissible	$ -	$ 158.12	$ 4,385.54	$ -	$ -	$ -
4. Agents' debit balances	2,100,887.73	621,022.94	782,078.67	1,290,937.99	1,261,098.61	672,509.96
10. Miscellaneous assets	162,157.39	321.44	(428.91)	17,144.63	(188.00)	1,001.00
Total Group I adjustments	$ 2,263,045.12	$ 621,502.50	$ 786,035.30	$ 1,308,082.62	$ 1,260,910.61	$ 673,510.96
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:						
20. Bonds	$ 1,298,026.44	$ 867,835.06	$ (721,218.51)	$ (238,451.05)	$ (287,510.72)	$ (85,345.76)
21. Stocks	(49,096,366.63)	(31,349,987.25)	(9,557,964.16)	17,133,338.40	(18,165,483.28)	17,935,205.10
22. Mortgage loans	-	-	-	-	(134,220.57)	(147,895.19)
23. Unrealized profit in mortgage loans	-	1,001,668.92	(149,897.21)	(228,481.22)	(489,069.82)	(134,220.67)
Total Group II adjustments	$(47,798,340.19)	$(29,480,483.27)	$(10,429,079.88)	$16,666,406.13	$(19,076,284.39)	$17,567,743.48
Group III--Provide for possible losses on certain assets:						
30. Agents' debit balances (estimated at 10%)	$ (210,088.77)	$ (62,102.29)	$ (78,207.87)	$ (129,093.38)	$ (126,109.86)	$ (67,251.00)
Group IV--Defer a portion of acquisition costs to future periods:						
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$ 19,644,227.07	$ 2,372,099.40	$ 3,183,969.87	$ 2,839,334.89	$ 1,838,118.47	$ 1,765,642.87
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	536,688.97	66,520.17	228,711.79	340,115.63	482,854.29	307,094.68
42. Accident and health insurance direct acquisition costs (deferred in same manner as Item 41)	97,879.82	3,581.92	(37,074.42)	27,977.98	77,858.31	12,056.13
Total Group IV adjustments	$ 20,278,795.86	$ 2,442,201.49	$ 3,375,607.24	$ 3,207,428.50	$ 2,398,831.07	$ 2,084,793.68
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:						
50. Record furniture and equipment	$ 1,966,171.16	$ 778,838.19	$ 1,016,468.86	$ 1,017,272.64	$ 954,224.60	$ 893,360.91
51. Record depreciation of furniture and equipment	(915,561.45)	(226,406.75)	(298,338.08)	(382,638.10)	(465,060.07)	(541,631.04)
52a. Reverse entry for change in book value of electronic computer	1,222,614.04	(57,122.00)	(411,723.00)	(549,542.91)	(202,226.13)	-
52b. Reverse entry for change in book value of special home office equipment	-	-	-	147,484.70	(24,992.72)	48,028.79
Total Group V adjustments	$ 2,273,223.75	$ 495,309.44	$ 306,407.78	$ 232,576.33	$ 261,945.68	$ 399,758.66
Group VI--Transfer certain losses and expenses to the proper year:						
63. Spread increase in pension fund reserve over ten years	$ -	$ -	$ -	$ 1,170,000.00	$ (130,000.00)	$ (130,000.00)
Total Adjustments	$(23,193,364.23)	$(25,983,572.13)	$ (6,039,237.43)	$22,455,400.20	$(15,410,706.89)	$20,528,555.78

Company S

As noted above, this firm is the stock life insurance company with admitted assets closest to $1 billion.

Underwriting and reserves

Company S wrote only industrial accident and health insurance during its early years but has written ordinary and industrial life insurance for over forty years. Life insurance in force is currently divided approximately 55 per cent ordinary, 44 per cent industrial and 1 per cent group. Accident and health insurance premiums comprised roughly one-sixth of the $178 million of premiums in 1962.[1]

Reserves are computed almost entirely on the net level premium plan with interest at not more than 2 3/4%. Policies originally issued at higher rates of assumed interest have all been revalued to lower rates.

Adjustments not previously discussed

Company S has obviously followed a policy of rigorously charging off all doubtful agents' debit balances, so no provision is made for losses from that source.

Adjustment 17. Unlisted assets--stocks of doubtful value.--This item provides another example of a basic philosophy of insurance reporting. Assets are either fully qualified as legal investments for insurance reserves or must be eliminated entirely. Yet, in this instance, the stocks had fully recovered their position within two years.

Adjustment 32. Difference between cost and market on stocks in Adjustment 17.--Under generally accepted accounting principles losses which have occurred must be recognized even if the asset has not been disposed of.

---

[1]See Appendix I.

This entry demonstrates how the stocks which are the subject of Adjustment 17 could be reduced to market, thus taking up the loss in the year in which they lost status. The account established with this entry is a contra account which should be deducted from the asset in order to tell the entire story and extend the market value into the total assets column of the balance sheet.

Life Insurance Company S
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$18,458,707.54	$13,881,203.32	$ 20,683,980.64	$ 21,894,991.07	$ 15,399,898.75	$90,318,781.32
Items Entered Direct to Surplus on Convention Blank:						
Capital gains (losses) on assets sold	150,275.54	20,378.09	307,382.35	430,170.35	274,718.34	
Change in value of assets owned at end of year	(887,690.20)	7,545,775.24	617,214.33	6,727,899.60	(5,076,023.72)	
Change in value of non-admitted and related items	(1,098,227.22)	727,921.66	(65,571.79)	130,693.01	(161,971.13)	
Retroactive 1958 Federal income tax	-	(3,227,925.02)	-	-	-	
Income from assets previously charged off	14,364.00	69,127.99	-	-	-	
Net per Convention Blank before items classed as dispositions of income	$16,637,429.66	$19,016,481.28	$ 21,543,005.53	$ 29,183,754.03	$ 10,436,622.24	96,817,292.74
Adjustments (see Schedule 1 for detail):						
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 949,133.72	$ (803,182.76)	$ 65,571.79	$ (130,693.01)	$ 1,769,030.71	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	28,692.53	(8,471,723.01)	(2,836,933.83)	(6,177,634.93)	3,370,813.23	
Group III--Provide for possible losses on certain assets	68,813.50	21,301.10	-	-	-	
Group IV--Defer a portion of acquisition costs to future periods	1,179,580.87	1,138,360.09	731,327.75	758,596.35	2,811,456.27	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost	61,043.15	69,204.29	295,625.26	213,114.32	191,554.54	
Group VI--Transfer certain losses and expenses to the proper year	(3,227,925.02)	3,227,925.02	-	-	-	
Total adjustments	$ (940,661.25)	$(4,818,115.27)	$ (1,744,409.03)	$ (5,336,617.27)	$ 8,142,854.75	(4,696,948.07)
Net income (loss) computed in conformance with "generally accepted accounting principles"	$15,696,768.41	$14,198,366.01	$ 19,798,596.50	$ 23,847,136.76	$ 18,579,476.99	92,120,344.67
Dispositions of Income:						
Transfer to appropriated surplus accounts:						
Mandatory securities valuation reserve	$ 101,652.18	$ 8,118,987.59	$ 2,243,606.99	$ 8,183,218.62	$ (2,568,398.47)	
Investment and mortality contingency fund	(101,652.18)	(506,771.96)	3,156,658.18	2,583,905.02	(3,702,189.30)	
Split up in the form of a stock dividend	5,000,000.00	-	-	-	6,000,000.00	
Cash dividends to stockholders	1,799,733.83	1,799,873.94	1,799,897.43	1,799,919.90	2,159,743.84	
Total dispositions of income	$ 6,799,733.83	$ 9,412,089.57	$ 7,200,162.60	$ 12,567,043.54	$ 1,889,156.07	
Net addition to (reduction of) unrestricted retained earnings	$ 8,897,034.58	$ 4,786,276.44	$ 12,598,433.90	$ 11,280,093.22	$ 16,690,320.92	
Beginning Unrestricted Retained Earnings	77,217,449.20	86,114,483.78	90,900,760.22	103,499,194.12	114,779,287.34	
Ending Unrestricted Retained Earnings	$86,114,483.78	$90,900,760.22	$103,499,194.12	$114,779,287.34	$131,469,608.26	
Ending Unassigned Surplus per Convention Blank	78,134,278.43	87,738,670.14	102,081,513.07	118,698,223.56	127,245,689.73	
Difference	$ 7,980,205.35	$ 3,162,090.08	$ 1,417,681.05	$ (3,918,936.22)	$ 4,223,918.53	
Proof:						
Difference at beginning of year	$ 8,920,866.60	$ 7,980,205.35	$ 3,162,090.08	$ 1,417,681.05	$ (3,918,936.22)	$ 8,920,866.60
Adjustments this year	(940,661.25)	(4,818,115.27)	(1,744,409.03)	(5,336,617.27)	8,142,854.75	(4,696,948.07)
Difference at end of year, as above	$ 7,980,205.35	$ 3,162,090.08	$ 1,417,681.05	$ (3,918,936.22)	$ 4,223,918.53	$ 4,223,918.53

Life Insurance Company S
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 12-31-57	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):						
3. Loans considered inadmissible	$ 58,430.50	$ (1,116.56)	$ 3,030.05	$ 8,516.96	$ (42,221.00)	$1,607,140.63
4. Agents' debit balances	19,309.48	24,572.93	47,199.90	47,485.52	27,863.52	(16,488.66)
10. Miscellaneous assets	393,152.15	1,074,770.85	(778,151.61)	9,569.31	(116,335.53)	178,378.74
17. Unlisted assets--stocks of doubtful value	224,354.60	(149,093.50)	(75,261.00)	-	-	-
Total Group I adjustments	$ 695,246.73	$ 949,133.72	$ (803,182.66)	$ 65,571.79	$ (130,693.01)	$1,769,030.71
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:						
21. Stocks	$ 1,610,103.35	$ 141,340.98	$(8,036,976.10)	$(2,726,949.03)	$(6,010,837.73)	$3,572,834.57
25. Change in capital gains as a result of these changes in the value of securities	-	(112,648.45)	(434,746.91)	(109,984.80)	(166,797.20)	(202,021.34)
Total Group II adjustments	$ 1,610,103.35	$ 28,692.53	$(8,471,723.01)	$(2,836,933.83)	$(6,177,634.93)	$3,370,813.23
Group III--Provide for possible losses on certain assets:						
32. Difference between cost and market on stocks in adjustment 17	$ (90,114.60)	$ 68,813.50	$ 21,301.10	$ -	$ -	$ -
Group IV--Defer a portion of acquisition costs to future periods:						
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$ 5,696,519.76	$ 1,185,805.55	$ 1,133,401.66	$ 758,478.90	$ 773,465.37	$2,690,839.86
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	134,236.73	(5,988.92)	6,159.43	(26,041.08)	(14,343.84)	116,439.15
42. Accident and health insurance direct acquisition costs (deferred in same manner as Item 41)	6,351.81	(235.76)	(1,201.00)	(1,110.07)	(525.18)	4,177.26
Total Group IV adjustments	$ 5,837,108.30	$ 1,179,580.87	$ 1,138,360.09	$ 731,327.75	$ 758,596.35	$2,811,456.27
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:						
50. Record furniture and equipment	$ 2,317,915.53	$ 384,060.00	$ 441,519.06	$ 397,043.52	$ 602,732.43	$ 675,587.77
51. Record depreciation of furniture and equipment	(1,868,651.00)	(240,491.10)	(303,869.97)	(326,413.90)	(351,588.57)	(381,836.70)
52. Reverse entry for net change in value of equipment	419,258.29	(82,525.75)	(68,444.80)	224,995.64	(38,029.54)	(102,196.53)
Total Group V adjustments	$ 868,522.82	$ 61,043.15	$ 69,204.29	$ 295,625.26	$ 213,114.32	$ 191,554.54
Group VI--Transfer certain losses and expenses to the proper year:						
60. Retroactive 1958 Federal income tax	$ -	$(3,227,925.02)	$ 3,227,925.02	$ -	$ -	$ -
Total Adjustments	$ 8,920,866.60	$ (940,661.25)	$(4,818,115.17)	$(1,744,409.03)	$(5,336,617.27)	$8,142,854.75

Company T

Company T provides a test of the materiality of the adjustments in a firm with admitted assets in the vicinity of $1 1/2 billion.

Underwriting and reserves

This company does a substantial volume of reinsurance and sub-standard risk business, but writes no industrial insurance. Of the life insurance written in 1962, 53.6 per cent was term insurance and 17.4 per cent group insurance.[1]

The net level premium plan is used in valuing reserves on policies issued by the company. Commencing in August, 1962, the 1958 CSO mortality table has been used in valuing reserves on new business using a 2 1/2% interest assumption for participating policies and 3% for non-participating policies. During the 10 1/2 years preceding adoption of the 1958 CSO table, the 1941 CSO table was used with similar interest assumptions. The maximum portion of premiums is therefore transferred to reserves on policies issued by the company.

Company T participates in several special plans of reinsurance. In these plans, the company uses the same reserve plan as the ceding company. A wide variety of methods are therefore followed on this insurance.

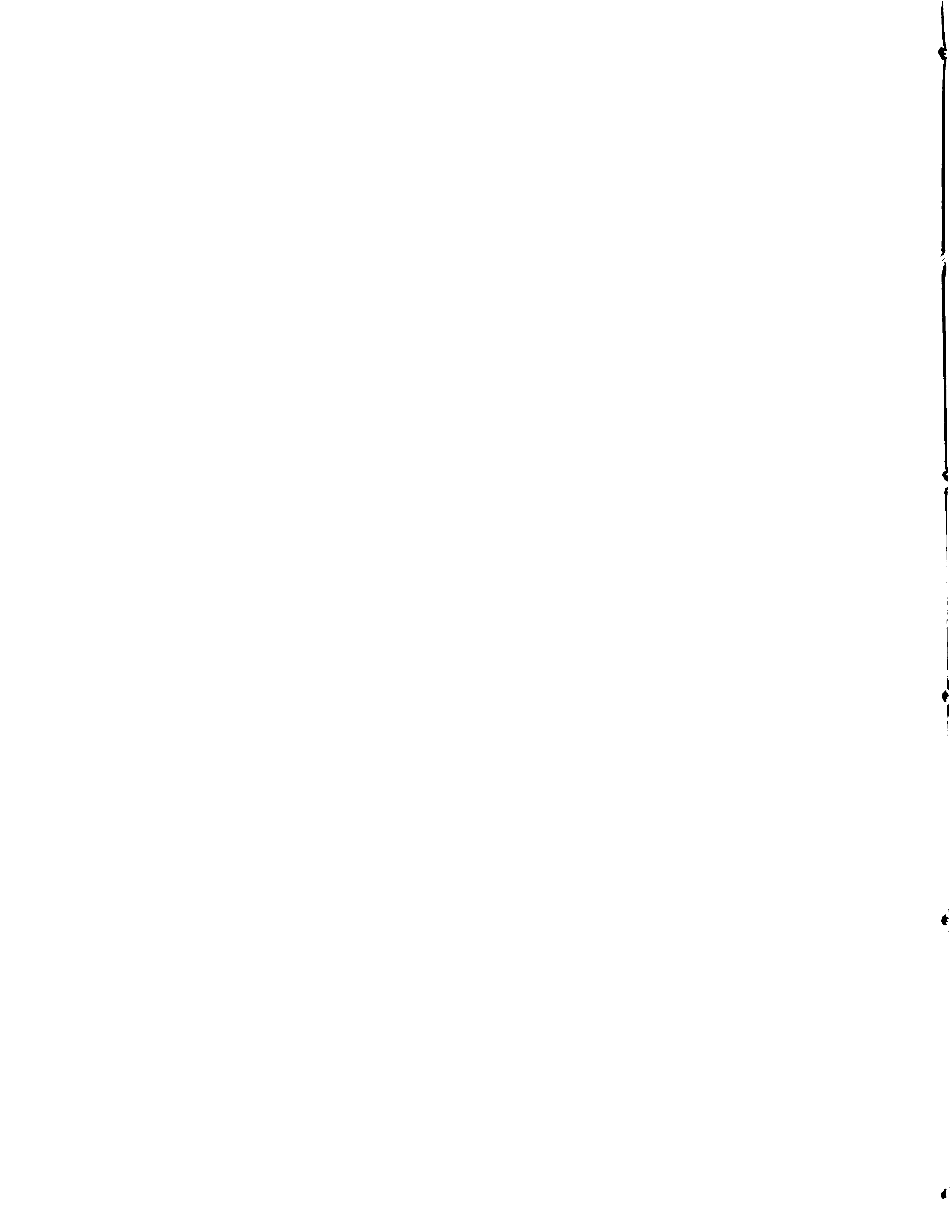
Adjustments not previously discussed

Adjustment 33. Provision for possible losses on bills and other receivables.--This adjustment is included to provide another demonstration

---

[1]See Appendix I for other pertinent underwriting data.

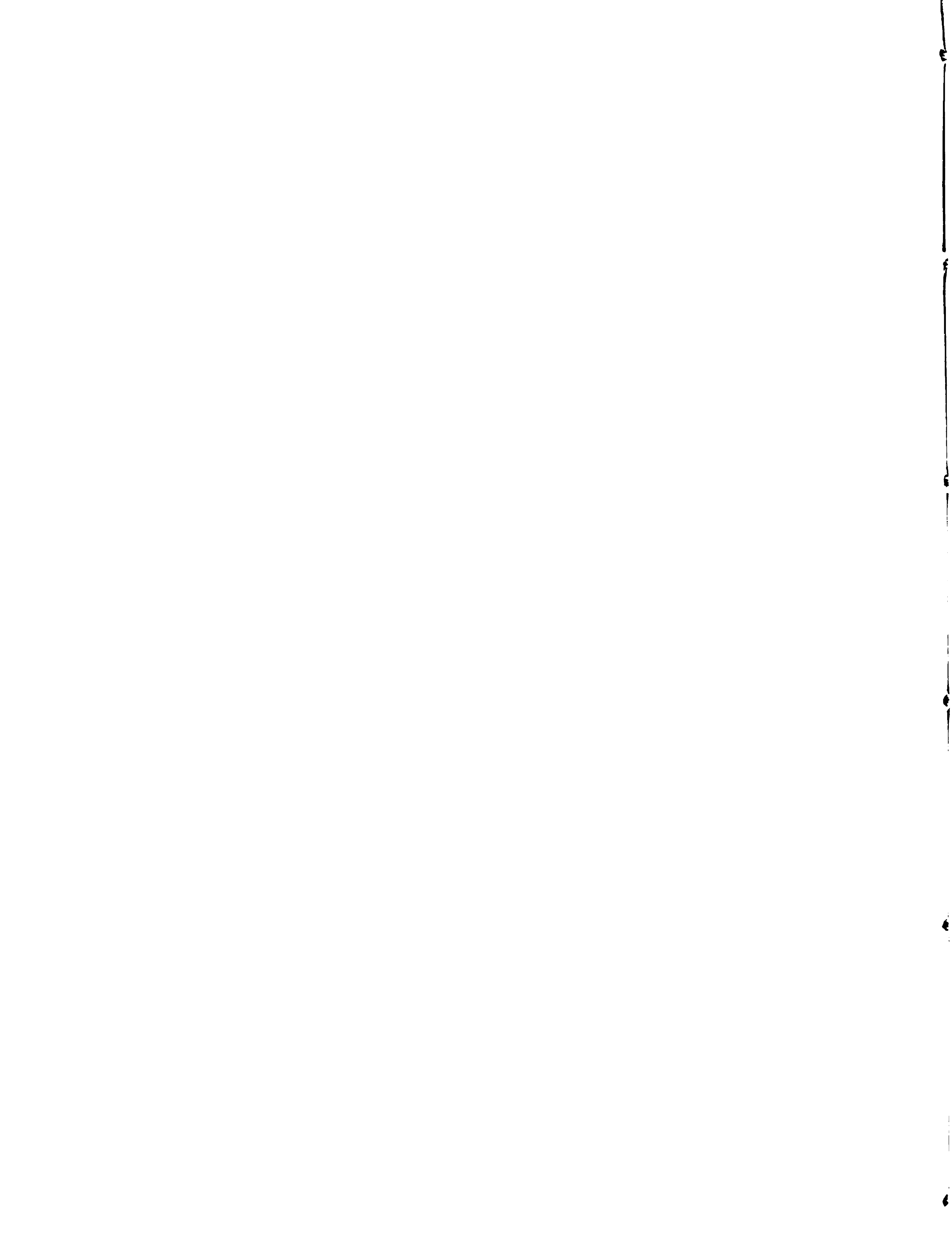
of the simplicity of setting up contra accounts for likely losses rather than considering the entire asset non-admitted when there is any doubt about its value. The 20 per cent estimate is, of course, arbitrary.



Life Insurance Company T
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$ 26,939,327.33	$ 21,987,605.79	$ 26,821,922.00	$ 29,884,811.46	$ 30,259,640.48	$135,893,307.06
Items Entered Direct to Surplus on Convention Blank:						
Capital gains (losses) on assets sold	1,211,328.23	610,187.70	(1,173,007.22)	(149,051.08)	(1,992,398.54)	
Change in value of securities owned at end of year	13,012,109.24	1,334,116.58	1,301,959.08	25,157,723.91	(10,291,540.79)	
Change in value of non-admitted and related items	(544,821.68)	(241,918.68)	(647,833.09)	(1,972,676.08)	(1,055,276.36)	
Retroactive 1958 Federal income tax	-	(4,700,000.00)	-	-	-	
Net per Convention Blank before items classed as dispositions of income	$ 40,617,943.12	$ 18,989,991.39	$ 26,303,040.77	$ 52,920,808.21	$ 16,920,424.79	155,752,208.28
Adjustments (see Schedule 1 for detail):						
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ (61,061.08)	$ 814,863.35	$ (20,324.51)	$ 1,534,891.90	$ 654,697.47	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	(12,240,643.76)	(2,772,791.60)	(1,552,860.22)	(24,968,839.56)	14,580,216.61	
Group III--Provide for possible losses on certain assets	(55,397.23)	(24,667.70)	(69,009.05)	(339,832.06)	(182,563.05)	
Group IV--Defer a portion of acquisition costs to future periods	308,460.66	319,552.70	590,739.67	570,078.77	7,356.76	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at amortized cost	50,258.76	184,098.99	422,546.70	61,444.82	57,390.85	
Group VI--Transfer certain losses and expenses to the proper year	(4,700,000.00)	4,700,000.00	-	-	-	
Total adjustments	$(16,698,382.65)	$ 3,221,055.74	$ (628,907.41)	$(23,142,256.13)	$ 15,117,098.64	(22,131,391.81)
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ 23,919,560.47	$ 22,211,047.13	$ 25,674,133.36	$ 29,778,552.08	$ 32,037,523.43	133,620,816.47
Dispositions of Income:						
Transfer to appropriated surplus accounts:						
Mandatory securities valuation reserve	$ 15,380,375.07	$ 3,500,831.15	$ 3,990,285.79	$ 27,326,795.20	$(10,072,996.62)	
Reserve strengthening	654,950.48	31,605,951.37	1,511,270.15	1,461,313.83	248,500.00	
Transfer from revaluation reserve	-	(31,605,951.37)	(1,511,270.15)	-	-	
Stock dividends to stockholders	-	-	-	5,000,000.00	-	
Cash dividends to stockholders	4,200,000.00	4,000,000.00	4,000,000.00	4,250,000.00	5,000,000.00	
Total dispositions of income	$ 20,235,325.55	$ 7,500,831.15	$ 7,990,285.79	$ 38,038,109.03	$ (4,824,496.62)	
Net addition to (reduction of) unrestricted retained earnings	$ 3,684,234.92	$ 14,710,215.98	$ 17,683,847.57	$ (8,259,556.95)	$ 36,862,020.05	
Beginning Unrestricted Retained Earnings	135,704,506.11	139,388,741.03	154,098,957.01	171,782,804.58	163,523,247.63	
Ending Unrestricted Retained Earnings	$139,388,741.03	$154,098,957.01	$171,782,804.58	$163,523,247.63	$200,385,267.68	
Ending Paid-in Surplus	2,681,732.00	2,681,732.00	2,681,732.00	2,681,732.00	2,681,732.00	
Total	$142,070,473.03	$156,780,689.01	$174,464,536.58	$166,204,979.63	$203,066,999.68	
Ending Unassigned Surplus per Convention Blank	143,951,678.98	155,440,839.22	173,753,594.20	188,636,293.38	210,381,214.79	
Difference	$ (1,881,205.95)	$ 1,339,849.79	$ 710,942.38	$(22,431,313.75)	$ (7,314,215.11)	
Proof:						
Difference at beginning of year	$ 14,817,176.70	$ (1,881,205.95)	$ 1,339,849.79	$ 710,942.38	$(22,431,313.75)	$ 14,817,176.70
Adjustments this year	(16,698,382.65)	3,221,055.74	(628,907.41)	(23,142,256.13)	15,117,098.64	(22,131,391.81)
Difference at end of year, as above	$ (1,881,205.95)	$ 1,339,849.79	$ 710,942.38	$(22,431,313.75)	$ (7,314,215.11)	$ (7,314,215.11)



Life Insurance Company T
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 12-31-57	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):						
4. Agents' debit balances	$ 2,474,593.20	$ 541,612.92	$ 253,853.33	$ 635,479.48	$ 513,080.52	$ 299,950.54
5. Premium notes, etc. in excess of net value and other policy liabilities on individual policies	184.06	615.33	(344.38)	(41.79)	(21.75)	961.25
7. Bills and other receivables	46,653.38	6,179.68	(3,588.15)	27,305.51	1,442,620.04	762,840.02
8. Foreign exchange	(301,686.69)	(609,469.01)	564,942.55	(683,067.71)	(420,786.91)	(409,054.34)
Total Group I adjustments	$ 2,219,743.95	$ (61,061.08)	$ 814,863.35	$ (20,324.51)	$ 1,534,891.90	$ 654,697.47
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:						
20. Bonds	$ 859,295.10	$ 95,683.49	$ 730,759.94	$ 371,616.41	$ 127,064.16	$(1,005,668.39)
21. Stocks	(4,005,012.57)	(12,024,057.92)	(3,129,892.57)	(1,720,306.32)	(24,969,287.85)	15,593,958.46
22. Mortgage loans	681,919.98	(322,254.82)	(206,074.52)	(111,667.46)	(41,923.18)	-
23a. Investment real estate	39,999.12	9,985.49	(16,319.71)	(3,355.43)	(11,150.86)	1,846.69
25. Change in capital gains as a result of other adjustments in this group	-	-	(151,264.74)	(89,147.42)	(73,541.83)	(99,200.15)
Total Group II adjustments	$(2,423,798.37)	$(12,240,643.76)	$(2,772,791.60)	$(1,552,860.22)	$(24,968,839.56)	$14,490,936.61
Group III--Provide for possible losses on certain assets:						
30. Agents' debit balances (estimated at 10%)	$ (247,459.32)	$ (54,161.29)	$ (25,385.33)	$ (63,547.95)	$ (51,308.05)	$ (29,995.05)
33. Bills and other receivables (estimated at 20%)	(9,330.77)	(1,235.94)	717.63	(5,461.10)	(288,524.01)	(152,568.00)
Total Group III adjustments	$ (256,790.09)	$ (55,397.23)	$ (24,667.70)	$ (69,009.05)	$ (339,832.06)	$ (182,563.05)
Group IV--Defer a portion of acquisition costs to future periods:						
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$13,714,439.15	$ 184,447.84	$ 277,435.13	$ 639,496.40	$ 498,158.14	$ (140,330.17)
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	404,443.52	109,577.82	8,613.62	(20,348.73)	62,069.81	132,660.89
42. Accident and health insurance direct acquisition costs (deferred in same manner as Item 41)	102,085.88	14,435.00	33,503.95	(28,408.00)	9,850.82	15,026.04
Total Group IV adjustments	$14,220,968.55	$ 308,460.66	$ 319,552.70	$ 590,739.67	$ 570,078.77	$ 7,356.76
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:						
50. Record furniture and equipment	$ 1,787,332.91	$ 234,610.04	$ 388,631.30	$ 670,844.49	$ 350,593.89	$ 370,028.56
51. Record depreciation of furniture and equipment	(730,280.70)	(184,351.28)	(204,532.31)	(248,297.79)	(289,149.07)	(312,637.71)
Total Group V adjustments	$ 1,057,052.21	$ 50,258.76	$ 184,098.99	$ 422,546.70	$ 61,444.82	$ 57,390.85
Group VI--Transfer certain losses and expenses to the proper year:						
60. Retroactive Federal income tax on 1958 income	$ -	$ (4,700,000.00)	$ 4,700,000.00	$ -	$ -	$ -
Total Adjustments	$14,817,176.25	$(16,698,382.65)	$ 3,221,055.74	$ (628,907.41)	$(23,142,256.13)	$15,027,818.64

Company U

Company U is the next largest stock life insurance company after Company T in terms of admitted assets, but there are four mutual companies between them. Total admitted assets of Company U are over $2 1/2 billion, which is $1 billion more than for Company T.

Underwriting and reserves

In common with most of the well established, largest firms, Company U values its reserves on the net level premium plan. Group insurance comprised over 60 per cent of the life insurance in force at December 31, 1962, and provided over half of the premiums in 1962. As can be seen in Appendix I, a substantial portion of these premiums are for accident and health insurance.

Adjustments not previously discussed

Adjustment 18. Accrued interest receivable.--This is just another example of a non-admitted asset which needs to be re-instated to the financial statements if they are to conform with generally accepted accounting principles. The principle is the same as for other non-admitted assets.

Life Insurance Company U
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank
To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$12,729,260.19	$13,835,324.96	$14,632,286.08	$ 15,585,213.79	$17,527,287.36	$ 74,309,372.38
Items Entered Direct to Surplus on Convention Blank:						
Capital gains (losses) on assets sold	(26,974.64)	220,092.15	265,785.86	195,911.14	(629,291.09)	
Change in value of securities owned at end of year	7,017,715.03	2,459,928.68	(1,678,975.26)	13,571,036.43	(4,653,183.62)	
Change in value of non-admitted and related items	(15,233.45)	(75,560.95)	86,545.78	27,346.21	16,595.02	
Net per Convention Blank before items classed as dispositions of income	$19,704,767.13	$16,439,784.84	$13,305,642.46	$ 29,379,507.57	$12,261,407.67	91,091,109.67
Adjustments (see Schedule 1 for detail):						
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ (169,762.07)	$ (15,826.13)	$ 318,752.36	$ 413,750.67	$ 364,717.85	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	(6,407,411.89)	(2,204,049.98)	1,378,444.98	(13,206,696.89)	5,678,858.97	
Group III--Provide for possible losses on certain assets	459.79	566.17	2,473.50	1,331.06	(428.31)	
Group IV--Defer a portion of acquisition costs to future periods	69,625.98	628,514.46	385,301.14	469,515.63	1,745,837.74	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at amortized cost	(134,722.15)	(119,913.03)	(81,463.09)	331,830.56	(287,721.87)	
Total adjustments	$(6,641,810.34)	$(1,710,708.51)	$ 2,003,508.89	$(11,990,268.97)	$ 7,501,264.38	(10,838.014.55)
Net income (loss) computed in conformance with "generally accepted accounting principles"	$13,062,956.79	$14,729,076.33	$15,309,151.35	$ 17,389,238.60	$19,762,672.05	80,253,095.12
Dispositions of Income:						
Transfer to appropriated surplus accounts:						
Mandatory securities valuation reserve	$ 7,840,008.85	$ 3,535,866.74	$ 132,089.46	$ 11,295,033.41	$(3,890,761.84)	
Contingency reserve	4,689,000.00	4,996,000.00	4,519,000.00	7,287,000.00	3,653,000.00	
Transfer to stockholders' trust	-	-	-	-	6,091,275.33	
Stock dividends to stockholders	-	-	-	12,000,000.00	-	
Cash dividends to stockholders	2,460,000.00	2,700,000.00	2,880,000.00	3,360,000.00	4,184,825.40	
Total dispositions of income	$14,989,008.85	$11,231,866.74	$ 7,531,089.46	$ 33,942,033.41	$10,038,338.89	
Net addition to (reduction of) unrestricted retained earnings	$(1,926,052.06)	$ 3,497,209.59	$ 7,778,061.89	$(16,552,794.81)	$ 9,724,333.16	
Beginning Unrestricted Retained Earnings	81,949,646.94	80,023,594.88	83,520,804.47	91,298,866.36	74,746,071.55	
Ending Unrestricted Retained Earnings	$80,023,594.88	$83,520,804.47	$91,298,866.36	$ 74,746,071.55	$84,470,404.71	
Ending Paid-in Surplus	400,000.00	400,000.00	400,000.00	400,000.00	400,000.00	
Total	$80,423,594.88	$83,920,804.47	$91,698,866.36	$ 75,146,071.55	$84,870,404.71	
Ending Unassigned Surplus per Convention Blank	78,372,437.52	83,580,355.62	89,354,908.62	84,792,382.78	87,015,451.56	
Difference	$ 2,051,157.36	$ 340,448.85	$ 2,343,957.74	$ (9,646,311.23)	$(2,145,046.85)	
Proof:						
Difference at beginning of year	$ 8,692,967.70	$ 2,051,157.36	$ 340,448.85	$ 2,343,957.74	$(9,646,311.23)	$ 8,692,967.70
Adjustments this year	(6,641,810.34)	(1,710,708.51)	2,003,508.89	(11,990,268.97)	7,501,264.38	(10,838,014.55)
Difference at end of year, as above	$ 2,051,157.36	$ 340,448.85	$ 2,343,957.74	$ (9,646,311.23)	$(2,145,046.85)	$ (2,145,046.85)

Life Insurance Company U
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 12-31-57	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):						
4. Agents' debit balances	$ 65,059.01	$ (4,597.93)	$ (5,661.71)	$ (24,734.96)	$ (13,310.57)	$ 4,283.06
8. Foreign exchange	-	(195,667.03)	(84,267.90)	393,705.92	401,809.89	393,009.86
10. Miscellaneous	84,757.41	19,831.38	81,222.66	(61,810.82)	(14,035.64)	(20,878.08)
18. Accrued interest receivable	7,028.42	10,671.51	(7,119.18)	11,592.22	39,286.99	(11,696.99)
Total Group I adjustments	$ 156,844.84	$ (169,762.07)	$ (15,826.13)	$ 318,752.36	$ 413,750.67	$ 364,717.85
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:						
20. Bonds	$ 502,467.00	$ (19,895.00)	$ 565,498.00	$ 3,080,151.25	$ (414,746.09)	$ (326,517.91)
21. Stocks	(8,455,149.74)	(6,579,007.57)	(2,959,540.77)	(1,824,577.30)	(13,731,088.84)	4,512,214.64
22. Mortgage loans	16,812.85	(5,434.45)	4,365.04	1,665.69	8,827.70	40,482.70
25. Change in capital gains as a result of other adjustments in this group	-	196,925.13	185,627.75	121,205.34	930,310.34	1,452,679.54
Total Group II adjustments	$(7,935,869.89)	$(6,407,411.89)	$(2,204,049.98)	$ 1,378,444.98	$(13,206,696.89)	$5,678,858.97
Group III--Provide for possible losses on certain assets:						
30. Agents' debit balances (estimated at 10%)	$ (6,505.90)	$ 459.79	$ 566.17	$ 2,473.50	$ 1,331.06	$ (428.31)
Group IV--Defer a portion of acquisition costs to future periods:						
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$12,097,092.44	$ (29,877.40)	$ 620,104.90	$ 437,897.14	$ 441,014.58	$1,530,780.21
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	280,198.98	33,233.36	(9,758.69)	3,244.17	8,382.00	192,032.97
42. Accident and health insurance direct acquisition costs (deferred in same manner as Item 41)	219,235.29	66,270.02	18,168.25	(55,840.17)	20,119.05	23,024.56
Total Group IV adjustments	$12,596,526.71	$ 69,625.98	$ 628,514.46	$ 385,301.14	$ 469,515.63	$1,745,837.74
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:						
50. Record furniture and equipment	$ 4,679,328.04	$ 343,755.02	$ 381,756.75	$ 494,508.15	$ 960,389.57	$ 382,337.50
51. Record depreciation of furniture and equipment	(797,356.10)	(478,477.17)	(501,669.78)	(575,971.24)	(628,559.01)	(670,059.37)
Total Group V adjustments	$ 3,881,971.94	$ (134,722.15)	$ (119,913.03)	$ (81,463.09)	$ 331,830.56	$ (287,721.87)
Total Adjustments	$ 8,692,967.70	$(6,641,810.34)	$(1,710,708.51)	$ 2,003,508.89	$(11,990,268.97)	$7,501,264.38

Company V

This is the largest stock life insurance company in the United States in terms of admitted assets, so completes the test of the materiality of the adjustments.

Underwriting and reserves

Substantial volumes of accident and health and of group insurance are written. Group insurance in force at December 31, 1962, comprised 81.6 per cent of all life insurance in force. Of the business written in 1962, 72.7 per cent was group insurance and 11.0% was term insurance. No industrial insurance is written.

Life insurance reserves are valued on the net level premium plan. The portion under various assumed interest rates is comparable to that of other large companies.

Adjustments not previously discussed

Adjustment 19. Accident and health insurance premiums over three months past due.--Company V carried these premiums on its books even though they are not admissible under insurance regulations. They are treated as non-admitted assets in the Convention Blank. This adjustment reinstates them to the balance sheet, but a large provision for losses is established with Adjustment 34.

Adjustment 34. Provision for possible losses on accident and health insurance premiums over three months past due.--This adjustment is used as a further demonstration that full accounting is best achieved by carrying receivables on the statements at the amount management expects to collect. This is achieved by deducting a contra account of the amount of expected

losses from the asset account. Stockholders would then receive full information from management. The 50 per cent provision is, of course, a purely arbitrary provision used to demonstrate that contra accounts can be used for large as well as small expected losses. Naturally, as soon as a particular premium becomes uncollectible, it should be eliminated from assets.

Life Insurance Company V
Adjustment of Gain From Operations and Changes in Surplus per Convention Blank To Agree With Earnings Computed in Conformance With "Generally Accepted Accounting Principles"

Exhibit A

	1958	1959	1960	1961	1962	Aggregate of Key Items
Net Gain (Loss) from Operations per Convention Blank	$ 32,017,161.80	$ 27,629,717.13	$ 26,472,625.86	$ 30,284,139.94	$ 29,717,324.26	$ 146,120,968.99
Items Entered Direct to Surplus on Convention Blank:						
Capital gains (losses) on assets sold	15,789.71	(1,909,888.87)	(122,969.67)	23,551,758.12	1,109,529.14	
Change in value of securities owned at end of year	50,465,361.92	19,883,748.79	3,150,493.95	26,979,964.27	(16,894,462.91)	
Change in value of non-admitted and related items	(507,226.85)	(308,270.58)	(74,307.15)	(298,686.26)	(385,339.71)	
Change in reserve for unauthorized reinsurance	327,058.36	27,635.00	(26,851.00)	(141,322.00)	(13,243.00)	
Contribution to retirement allowance fund	(515,000.00)	(799,925.46)	(1,016,000.00)	(850,502.00)	(1,127,502.00)	
Adjustment of prior years' tax	-	(4,038,648.97)	(253,831.00)	(207,785.75)	(652,404.10)	
Net per Convention Blank before items classed as dispositions of income	$ 81,803,144.94	$ 40,484,367.04	$ 28,129,160.99	$ 79,317,566.32	$ 11,753,901.68	241,488,140.97
Adjustments (see Schedule 1 for detail):						
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V)	$ 174,334.85	$ (9,650.42)	$ 921,715.15	$ 1,081,443.85	$ 1,414,342.43	
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost	(50,243,025.11)	(19,686,810.47)	(4,152,397.82)	(27,068,216.30)	15,900,499.03	
Group III--Provide for possible losses on certain assets	(180,500.05)	(34,363.46)	24,644.75	49,474.89	(91,784.67)	
Group IV--Defer a portion of acquisition costs to future periods	131,839.39	111,014.27	[illegible]74,919.42	250,006.42	285,655.01	
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at amortized cost	382,955.04	394,786.69	475,478.13	498,552.16	721,093.42	
Group VI--Transfer certain losses and expenses to the proper year	(4,038,648.97)	4,038,648.97	-	-	-	
Total adjustments	$ (53,773,044.85)	$ (15,186,374.42)	$ (2,355,640.37)	$ (25,188,738.98)	$ 18,229,805.22	(78,273,993.40)
Net income (loss) computed in conformance with "generally accepted accounting principles"	$ 28,030,100.09	$ 25,297,992.62	$ 25,773,520.62	$ 54,128,827.34	$ 29,983,706.90	163,214,147.57
Dispositions of Income:						
Transfers to appropriated surplus accounts:						
Mandatory securities valuation reserve	$ 20,900,000.00	$ 4,900,000.00	$ 7,780,000.00	$ 30,400,873.00	$ (15,530,873.00)	
Contingency reserve	26,925,000.00	8,500,000.00	(10,425,000.00)	11,100,000.00	(14,400,000.00)	
Reserve strengthening	4,702,098.00	5,007,734.00	(2,117,037.00)	(1,718,899.00)	(1,059,082.00)	
Dividends to stockholders (includes $10 million stock in 1959)	10,200,000.00	19,100,000.00	11,200,000.00	12,800,000.00	12,800,000.00	
Total dispositions of income	$ 62,727,098.00	$ 37,507,734.00	$ 6,437,963.00	$ 52,581,974.00	$ (18,189,955.00)	
Net addition to (reduction of) unrestricted retained earnings	$ (34,696,997.91)	$ (12,209,741.38)	$ 19,335,557.62	$ 1,546,853.34	$ 48,173,661.90	
Beginning Unrestricted Retained Earnings	82,161,485.99	47,464,488.08	35,254,746.70	54,590,304.32	56,137,157.66	
Ending Unrestricted Retained Earnings	$ 47,464,488.08	$ 35,254,746.70	$ 54,590,304.32	$ 56,137,157.66	$ 104,310,819.56	
Ending Paid-in Surplus	6,000,000.00	6,000,000.00	6,000,000.00	6,000,000.00	6,000,000.00	
Total	$ 53,464,488.08	$ 41,254,746.70	$ 60,590,304.32	$ 62,137,157.66	$ 110,310,819.56	
Ending Unassigned Surplus per Convention Blank	210,073,853.39	213,050,486.43	234,741,684.42	261,477,276.74	291,421,133.42	
Difference	$(156,609,365.31)	$(171,795,739.73)	$(174,151,380.10)	$(199,340,119.08)	$(181,110,313.86)	
Proof:						
Difference at beginning of year	$(102,836,320.46)	$(156,609,365.31)	$(171,795,739.73)	$(174,151,380.10)	$(199,340,119.08)	$(102,836,320.46)
Adjustments this year	(53,773,044.85)	(15,186,374.42)	(2,355,640.37)	(25,188,738.98)	18,229,805.22	(78,273,993.40)
Difference at end of year, as above	$(156,609,365.31)	$(171,795,739.73)	$(174,151,380.10)	$(199,340,119.08)	$(181,110,313.86)	$(181,110,313.86)

Life Insurance Company V
Detailed Schedule of Adjustments
To Make the Financial Statements Conform With "Generally Accepted Accounting Principles"

Schedule 1

	Cumulative Adjustment 12-31-57	1958	1959	1960	1961	1962
Group I--Place non-admitted assets on the statements (other than fixed assets which are in Group V):						
2. Advances to agents or officers	$ 60,723.48	$ 1,920.06	$ 104,424.35	$ 69,475.79	$ (143,527.56)	$ (8,614.58)
4. Agents' debit balances	111,272.56	146,126.28	75,562.57	(32,225.90)	301,880.33	229,083.01
5. Premium notes, etc. in excess of net value and other policy liabilities on individual policies	38,258.00	20,108.00	(1,921.00)	(1,592.00)	(2,771.00)	22,246.00
7. Bills receivable	-	-	28,469.60	(12,143.00)	(8,986.00)	(7,340.60)
8. Foreign exchange	(282,000.00)	(353,000.00)	(316,000.00)	849,000.00	972,000.00	977,000.00
10. Miscellaneous	222,261.89	27,405.67	46,199.67	92,044.57	122,173.91	64,215.33
19. Accident and health insurance premiums over three months past due	166,643.41	331,774.84	53,614.39	(42,844.31)	(159,325.83)	137,753.27
Total Group I adjustments	$ 317,159.34	$ 174,334.85	$ (9,650.42)	$ 921,715.15	$ 1,081,443.85	$ 1,414,342.43
Group II--Reverse adjustment of securities to N.A.I.C. values, thus returning them to amortized cost:						
20. Bonds	$ 278,578.00	$ (62,000.00)	$ 102,000.00	$ 1,759,360.00	$ 1,329,318.00	$ 44,250.00
21. Stocks	(114,996,535.04)	(50,181,025.11)	(19,788,810.47)	(5,911,757.82)	(28,397,534.30)	15,856,249.03
Total Group II adjustments	$(114,717,957.04)	$(50,243,025.11)	$(19,686,810.47)	$(4,152,397.82)	$(27,068,216.30)	$15,900,499.03
Group III--Provide for possible losses on certain assets:						
30. Agents' debit balances (estimated at 10%)	$ (11,127.26)	$ (14,612.63)	$ (7,556.26)	$ 3,222.59	$ (30,188.03)	$ (22,908.03)
34. Accident and health insurance premiums over three months past due (estimated at 50%)	(83,321.70)	(165,887.42)	(26,807.20)	21,422.16	79,662.92	(68,876.64)
Total Group III adjustments	$ (94,448.96)	$ (180,500.05)	$ (34,363.46)	$ 24,644.75	$ 49,474.89	$ (91,784.67)
Group IV--Defer a portion of acquisition costs to future periods:						
40. First year life insurance commissions (arbitrarily allocated evenly over a five year period)	$ 9,940,065.20	$ 188,207.00	$ 257,781.72	$ 394,857.93	$ 232,836.00	$ 261,189.76
41. Accident and health insurance commissions (deferred in proportion to unearned premium reserve)	327,098.96	(45,466.35)	(84,041.70)	(9,522.79)	(3,567.85)	9,972.28
42. Accident and health insurance direct acquisition costs (deferred in same manner as Item 41)	269,978.88	(10,901.26)	(62,725.75)	(10,415.72)	20,738.27	14,492.97
Total Group IV adjustments	$ 10,537,143.04	$ 131,839.39	$ 111,014.27	$ 374,919.42	$ 250,006.42	$ 285,655.01
Group V--Place non-admitted fixed assets on the statements and carry all fixed assets at depreciated cost:						
50. Record furniture and equipment	$ 2,030,155.64	$ 598,070.68	$ 653,790.06	$ 788,545.79	$ 678,586.79	$ 1,195,075.02
51. Record depreciation of furniture and equipment	(908,372.48)	(215,115.64)	(259,003.37)	(313,067.66)	(366,506.04)	(444,224.88)
52. Reverse entry for change in net book value of furniture and equipment	-	-	-	-	186,471.41	(29,756.72)
Total Group V adjustments	$ 1,121,783.16	$ 382,955.04	$ 394,786.69	$ 475,478.13	$ 498,552.16	$ 721,093.42
Group VI--Transfer certain losses and expenses to the proper year:						
60. Retroactive Federal income tax on 1958 income	$ -	$ (4,038,648.97)	$ 4,038,648.97	$ -	$ -	$ -
Total Adjustments	$(102,836,320.46)	$(53,773,044.85)	$(15,186,374.42)	$(2,355,640.37)	$(25,188,738.98)	$18,229,805.22

SUMMARY

The only times when the adjustments are not material appear to be when the volume and type of insurance written is constant and when the market value of investments is stable. Even though the earnings measurement is not perfect it gives a better indication of operating adjusted results than the Convention Blank. Research and experimentation by the companies directed toward practical solutions of technical problems is therefore recommended.

As the analyses in this chapter progressed, it became increasingly clear that the need for stockholder oriented, going concern statements which conform with generally accepted accounting principles varies with the rate of growth of the firm, the reserve valuation methods employed, the kinds of insurance sold, and the investment policies adopted. Size is relatively unimportant, but the particular adjustments which are most significant may vary with the age and size of the firm.

The companies are so different that comparison between them is misleading unless the basic underwriting and reserve practices are first pinpointed and contrasted. Table 5 is designed to provide a concise over-view of the materiality of the adjustments, but must be interpreted in light of the comments in the discussion of each firm. The data in Appendix I should also be reviewed.

A few additional words of caution are also in order. The largest items entered direct to surplus by many of the firms are the gains and losses from change in the market value of securities. The net negative adjustment caused by elimination of these unrealized gains in some of the companies should not be allowed to obscure the effect of other adjustments.

Table 5: Comparison of Selected Totals for the Firms Subjected to the Abbreviated Analysis

			Totals For All of The Years Analyzed			
Firm	No. of Years Analyzed	Total 1962 Premiums	Net Gain (Loss) From Operations Per Convention Blank	Net Per Convention Blank Before Items Classed As Dispositions Of Income	Total Adjustments	Net Income Under Generally Accepted Accounting Principles
Nebraska Companies						
G	6	$ 86,000	$ 11,000	$ 7,000	$ 31,000	$ 38,000
H	2	181,000	(164,000)	(217,000)	116,000	(101,000)
I	2	127,000	(238,000)	(302,000)	93,000	(209,000)
J	2	662,000	(116,000)	(139,000)	328,000	189,000
K	3	710,000	(138,000)	(308,000)	539,000	231,000
L(1)[a]	5		1,272,000	1,284,000	129,000	1,413,000
L(2)	3		(67,000)	885,000	(650,000)	235,000
L(3)	5	4,752,000	1,139,000	1,854,000	(141,000)	1,713,000
Foreign Companies						
M	5	65,565,000	21,213,000	20,897,000	1,741,000	22,638,000
N	5	51,000,000	15,726,000	18,274,000	1,218,000	19,492,000
O	5	71,797,000	19,845,000	30,233,000	(10,400,000)	19,833,000
P	5	33,604,000	21,110,000	20,992,000	94,000	21,086,000
Q	5	109,623,000	61,608,000	62,556,000	1,200,000	63,756,000
R	5	136,729,000	64,686,000	119,340,000	(4,449,000)	114,891,000
S	5	178,314,000	90,319,000	96,817,000	(4,697,000)	92,120,000
T	5	246,908,000	135,893,000	155,752,000	(22,131,000)	133,621,000
U	5	398,228,000	74,309,000	91,091,000	(10,838,000)	80,253,000
V	5	852,640,000	146,121,000	241,488,000	(79,211,000)	162,277,000
				$860,504,000	$(127,028,000)	$733,476,000

Sources: The four right columns--Exhibit A for each company.
Total 1962 Premiums--Blythe & Co., The Insurance Stock Survey for all of the foreign companies except Company N; Other companies from the Convention Blank.

[a]L(1) is the old "Northern" company before merger, 1953 to 1957.
L(2) is the new "Southern" company before merger, 1955 to 1957.
L(3) is the merged company, 1958 to 1962.

Similarly, the closeness of the net gain from operations and the revised net income for some of the firms should not be allowed to obscure the fact that realized capital gains are entered direct to surplus in the Convention Blank, but may be an integral part of the return on investment in stocks.

The 1962 premiums are included in Table 5 as an indication of the size of the company. Care should be taken to note that these are premiums for just one year, whereas the four columns to the right contain totals for all years.

A final admonition repeats two warnings which have been repeatedly sounded in preceding discussion. First, Federal income tax expense is not adjusted for the change in income made by the adjustments, nor is any attempt made to compute the amount of income tax deferred by the half of underwriting profits held in the tax return Tier III "policyholder surplus." Second, the adjustments and financial statements are not sufficiently refined nor technically accurate enough for adoption in practice in their present form. They have served as effective research tools. If, in addition, they provide a starting point for discussion and additional research, they will have served well.

CHAPTER VI

CONCLUSIONS

The objectives outlined in the first chapter have been reached. The contrasts in the underlying frameworks which are outlined in Chapter II reveal many reasons for differences between the financial statements of life insurance companies and the financial statements of commercial and industrial firms. Reasonable success in reaching the other objectives is indicated by the fact that the four questions posed at the beginning of Chapter III can be answered in the affirmative with only minor qualifications: (1) All of the important adjustments except those involving direct acquisition costs of life insurance policies and those which are excluded from consideration by the limitations imposed upon this study can be computed from the information in the detailed schedules of the Convention Blank. (2) A few assumptions are required in order to make the adjustments in this study, but the companies should have little difficulty compiling the information in practice. (3) The adjustments have a material effect on the financial statements of some companies and only a mild effect on others. This is significant because the greatest impact of the adjustments is in those firms where stockholders need to make the most careful evaluations. (4) Important information not now available to stockholders is included in the revised and extended statements designed in this study.

The preceding conclusions are amplified and supported in this chapter. Items "1" and "2" are considered together under the caption of "Feasibility

of Making the Adjustments in Practice." Items "3" and "4" are discussed separately. First, however, it is helpful to review some of the key contrasts in basic frameworks.

BASIC FRAMEWORKS

Both the financial statements of commercial and industrial firms which follow generally accepted accounting principles and life insurance company financial statements have evolved gradually to meet the needs of the users of the statements. Each is based on a different set of assumptions and is constructed on a different basic framework.

The statements of commercial and industrial firms

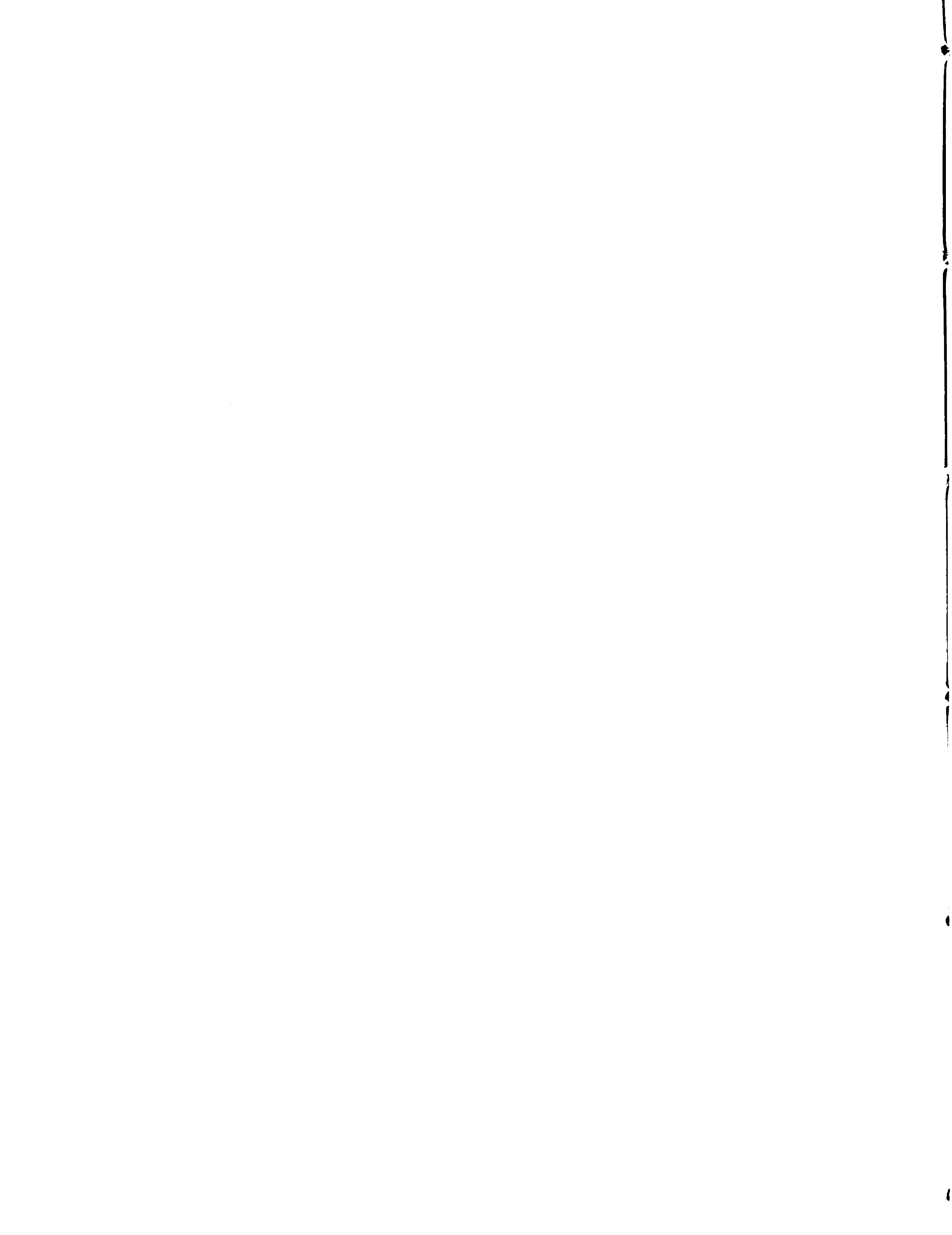
Commercial financial statements are constructed on a framework of double entry bookkeeping records summarized into financial statements emphasizing accountability, or stewardship, by management. Even though this system developed in response to a need for information which management could use to evaluate its own past actions, the principles which are currently referred to in the standard certified public accountant's certificate are directed toward reports to outsiders. These principles encompass a broad spectrum of complex but as yet not specifically defined concepts which should apply to all businesses. They include assumptions and minimum requirements which the financial world has accepted as those which the reader can assume have been followed unless he is notified otherwise. Whenever the business situation or the method of statement presentation does not fit one of the underlying assumptions, both the independent certified public accountant and management have an obligation to warn readers that the statements are not based on the standard assumptions or framework. This warning is ordinarily given in the certificate and also through the construction of the statements or in footnotes.

Even though concentration in this study is upon the basic assumptions and frameworks, it is important to recognize that accounting data are useful far beyond the reaches of those who are interested in a report of accountability by management. Much of the usefulness of accounting is derived from the accuracy, objectivity, control and reliability which are inherent in the double entry--accountability framework. Data with these characteristics have many uses. For example, internal management analyses, such as cost accounting, are tied to the double entry records in order to take advantage of the inherent characteristics of those records.

The earnings statement is an important part of the report of accountability by management. Earnings are both one of the sources of funds for which management must account and a measure of how well it has used the resources of the firm to build earning power. One of the most important attributes of double entry bookkeeping is the complete integration of the earnings statement and balance sheet accounts.

The statements of life insurance companies

Life insurance company financial statements, by contrast, are constructed around a balance sheet which is basically an elaborate formula for the computation of legal surplus. The earnings statement has only recently been integrated with this balance sheet. The basic methodology is one of valuation of liabilities and assets rather than measurement of revenue and allocation of costs and expenses against that revenue, as in commercial accounting. The maximum valuation of assets is rigidly controlled by the state insurance departments, but the companies are permitted a range of discretion in choice of method of valuation of reserves, the largest liability.



The legal surplus which is computed in the insurance company balance sheet is used by the state insurance departments as a first line indicator of the solvency of the company. Ultra-conservatism is built into the statement, apparently on the theory that if a company can show an excess of assets over liabilities and capital stock under the restrictions imposed, state officials may justifiably assume that the company has sufficient resources to carry out the provisions of every policy in force.

The going concern assumption is not part of life insurance statements. However, it is not accurate to say that a liquidation postulate is followed. The solvency which is indicated by the insurance company balance sheet is forward looking. If all actuarial assumptions were exactly fulfilled, a "solvent" life insurance company could stop writing insurance and still be able to fulfil the terms of every policy.

In many respects the Convention Blank is similar to the audit work-papers which are prepared by certified public accountants. The blank is designed for study by the experts in the state insurance departments. They may use it in a manner not too different from the use made of the audit workpapers by a manager or partner in an accounting office as he reviews a report he is asked to approve. The information in this blank is, of course, also extremely valuable to the internal management of the companies, just as the financial reports of commercial and industrial firms are useful to the management of those firms.

FEASIBILITY OF MAKING THE ADJUSTMENTS IN PRACTICE

The adjustments are designed to provide statements suitable for inclusion in reports to stockholders and other public users. No changes in the Convention Blank are considered. With the exception of factors

involving direct acquisition costs of life insurance policies, enough detailed information is included in the Convention Blank to make all of the adjustments. The only important assumptions which have to be made are for such factors as the expected useful life of furniture and equipment and the portion of agents' debit balances which will probably never be collected. Life insurance companies should have no more difficulty with these factors than firms in other industries. In short, all that is involved in most of the adjustments is moving information from the detailed schedules in the Convention Blank to the primary statements.

The adjustment for direct acquisition costs of life insurance is another matter. This adjustment attempts to achieve realistic matching of the cost of acquiring policies with the revenue from insurance premiums. The adjustment is made on a purely arbitrary basis in this study. Moreover, it is computed in the same way for all firms regardless of the reserve valuation method used.

It may be worth reviewing the reasons for adopting the particular adjustment procedure for direct acquisition costs of life insurance policies at this point as an indication of the problems involved. Even though there are other direct acquisition costs, first-year commissions are the only costs capitalized in this study for life insurance policies. For those firms which use modified preliminary term reserve valuation methods, the difference between the reserve established under these methods and the reserve which would be required under the full net level premium plan is likely sufficient to allocate all acquisition costs other than commissions over the premium paying period of the policy. Renewal commissions are normally paid over nine or ten years, often with a service

fee thereafter, so are already allocated on a conservative but realistic basis. Amortization of first-year commissions over the five-year select mortality period may, therefore, give adequate consideration to the high second and third year lapse rate and provide an over-all effect which is fairly reasonable as compared to scientific computation.

It must be emphasized that the mechanics of this adjustment are an arbitrary research technique designed to find out if further research at the company level should be recommended. In practice, it is possible that the pertinent information would have to be handled on an individual policy, or group of policies, basis. Only those costs not recovered through use of preliminary term reserve valuation methods should be capitalized. Furthermore, unamortized costs would have to be charged to expense at the time of lapse or death. Whether or not all of the pertinent factors involved could be handled on a practical basis is something which can be answered only through experimentation by the companies themselves. It is reasonable to believe, however, that what was impossible a few years ago may now be easily and inexpensively handled by automatic data processing equipment.

The method outlined above is not the only possibility. In an article which was published as this thesis was being readied for typing, Reynolds Griffith investigates several possible methods of capitalizing acquisition costs and allocating them to expense. He concludes that "application of generally accepted principles to life insurance companies presents no insurmountable obstacles."[1] It is also worthy of note that when the adjustments were discussed with actuaries, the way expenses are handled in the

---

[1]"A Note on Life Insurance Accounting," The Journal of Risk and Insurance, V. 31, No. 2 (June, 1964) 215.

gross premium method of reserve valuation which is used in England was often injected into the conversation. This method would involve changes in the concept of regulation so is beyond the scope of this study. It is mentioned here to indicate that there are other ways of handling acquisition costs.

The importance of reserve valuation methods was mentioned above, but is so little understood outside the insurance industry that it needs special emphasis. Insurance companies have considerable control over the portion of revenue transferred to reserves through choosing among several acceptable reserve valuation methods and by selecting either a high or a low interest allowance. Many young companies choose one of the preliminary term reserve valuation plans and a fairly high interest assumption. Later, as earnings commence to climb, the reserves are sometimes "strengthened" by changing to the net level reserve valuation plan or by lowering the interest assumption. Most of the large well-established companies use net level valuation methods for the majority of their policies. If revised and extended financial statements which conform with generally accepted accounting principles are to provide reasonable comparability between firms, the adjustment for direct acquisition costs must take proper cognizance of the reserve valuation methods used by each firm.

MATERIALITY AND SIGNIFICANCE OF THE ADJUSTMENTS

The reconciliation statements[1] reflect the materiality and significance of the adjustments for each of the companies analyzed. So many factors are interrelated that it is dangerous to summarize very far beyond

---

[1]Exhibit II for the companies analyzed in detail and Exhibit A for the companies subjected to the abbreviated analysis.

those statements. However, the three earnings computations[1] from the reconciliations were compared for the companies subjected to the abbreviated analysis in Table 5 at the conclusion of Chapter V in an attempt to summarize key over-all relationships.

Net income reported to stockholders

The income statements included in annual reports to stockholders stop with the Convention Blank operating gain or loss.[2] Another type of summary is, therefore, presented in Table 6. Percentages are used to emphasize the materiality of the differences between the earnings emphasized in reports to stockholders and net income computed in accordance with generally accepted accounting principles. Care must be taken, however, not to overemphasize individual percentage amounts without first checking the individual company statements in the analytical chapters to see if a particular percentage change is caused by the adjustments or if it is the mathematical result of comparison with a Convention Blank operating gain which is relatively close to zero. The pertinent figures are included in Columns 1, 2 and 3 in Table 6 for the aggregate income of the total period analyzed, but space does not permit doing so for the annual computations.

---

[1](1) Net gain or loss from operations per the Convention Blank, (2) Net per Convention Blank before items classed as dispositions of income, and (3) Net income computed in conformance with generally accepted accounting principles.

[2]Some, but not all, companies also include a summary of changes in surplus. Of the twenty 1962 reports analyzed by the Sub-committee on Life Insurance Company Annual Reports for Shareholders of the Financial Analysts Federation, "only nine companies published a complete surplus reconciliation statement." Special Report to the Membership, December, 1963.

Important items, which are included in the income statement by commercial firms even when the current operating concept is followed, are entered direct to Surplus by life insurance companies.

Table 6: Comparison of the Increase (Decrease) in Net Income Computed in Conformance With Generally Accepted Accounting Principles Over the Net Gain from Operations per the Convention Blank

Company	(1) Totals for All Years Analyzed: Net Gain (Loss) From Operations Per Convention Blank	(2) Net Income (Loss) Under Generally Accepted Accounting Principles	(3) Difference	(4) Per Cent of Col. 3 to Col. 1	Annual Percentages of Increase (Decrease) in Income Computed in the Same Manner As Column 4: 1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
COMPANIES ANALYZED IN DETAIL (All Nebraska domestic companies):														
A	$ 4,911,417	$ 4,985,368	$ 73,951	1.5%		10.5%	4.4%	(1.0)%	(.5)%	1.3%	.9%	(.5)%	8.4%	(1.6)%
B	824,307	2,729,985	1,905,678	231.2	528.8%	610.3	192.1	96.6	145.8	(26.0)	1,981.3	247.4	108.3	1,978.3
C	1,296,084	1,619,887	323,803	25.0	161.1	1,195.4	49.0	116.3	36.6	225.3	1.9	(8.8)	(12.2)	(13.9)
D	(233,372)	(133,108)	100,264	43.0	(120.3)	(106.6)	(235.2)	64.0	12.5	(21.8)	(100.3)	(162.0)	46.4	45.3
E	(456,894)	9,860,672	10,317,566	2,258.2	67.5	34.2	440.3	69.6	8,492.9	340.6	4,658.7	19,942.1	213.9	50.8
F	52,358,072	56,051,862	3,693,790	7.1	4.2	17.0	8.4	16.0	16.6	.8	27.7	3.1	13.8	9.9
COMPANIES SUBJECTED TO ABBREVIATED ANALYSIS:														
Nebraska domestic companies:														
G	11,380	37,966	26,586	233.6					70.5	177.8	56.6	57.1	121.4	(67.8)
H	(163,525)	(100,411)	63,114	38.6									52.5	27.2
I	(237,618)	(209,202)	28,416	12.0									.1	12.3
J	(115,879)	189,120	304,999	263.2									.1	393.5
K	(138,418)	231,419	369,837	267.2								238.3	544.2	182.3
L(1)	1,272,589	1,413,249	140,660	11.1	18.8	27.0	20.9	2.5	(1.3)					
L(2)	(66,682)	235,253	301,935	452.8			166.5	8,338.0	191.9					
L(3)	1,139,428	1,712,871	573,443	50.3						99.6	143.6	6.5	.7	36.9
Foreign companies:[a]														
M	21,212,657	22,638,113	1,425,456	6.7						6.3	9.6	8.7	7.0	9.5
N	15,725,465	19,492,149	3,766,684	24.0						12.0	29.0	8.4	28.9	35.9
O	19,844,959	19,833,372	(11,587)	(.1)						(10.2)	6.6	6.5	(8.9)	7.7
P	21,145,030	21,085,759	(59,271)	(.3)						.1	(2.4)	.2	4.0	(3.0)
Q	61,608,393	63,756,130	2,147,737	3.5						(4.5)	11.4	4.0	3.3	3.3
R	64,685,568	114,890,869	50,205,301	77.6						52.4	44.3	175.0	81.2	47.7
S	90,318,781	92,120,345	1,801,564	2.0						(14.9)	2.3	(4.3)	8.9	20.6
T	135,893,307	133,620,816	(2,272,491)	(1.7)						(11.2)	1.0	(4.3)	(.4)	5.9
U	74,309,372	80,253,095	5,943,723	8.0						2.6	6.5	4.6	11.6	12.8
V	146,120,969	163,214,148	17,093,179	11.7						(12.5)	(8.4)	(2.6)	78.7	.9

Source: Computed from Exhibit II of the companies analyzed in detail and Exhibit A of the companies subjected to the abbreviated analysis.

[a]Foreign companies are defined as those chartered in a state other than Nebraska.

If the limitations of percentage comparisons of net figures, some of which are losses, are kept in mind, Table 6 effectively shows that the adjustments cause material changes in the net income reported to stockholders in some instances and almost no change in other instances. Similarly, annual fluctuations vary from company to company.

The explanation for this wide variation in the materiality and significance of the changes in earnings as a result of the adjustments involves such factors as the age of the company, the rate of growth of the firm, the kinds of insurance sold, the reserve valuation methods employed, and the investment policies adopted. These factors are reviewed in the introductory remarks to the discussion of each company analysis in Chapters IV and V.

The following example indicates the impact of one of these factors. Company E expanded its annual premiums written from approximately $8 million in 1952 to nearly $24 million in 1962. Company F's expansion was much less rapid; annual premiums rose from $43 million in 1952 to only $61 million in 1962. There are other factors involved, of course, but this one consideration is a substantial part of the reason for the rather uniform and mild effect of the adjustments on the earnings of Company F compared to the dramatic change for Company E which is reflected in Table 6. A change from an aggregate loss for a ten-year period to an average income of nearly $1 million a year is both material and significant in a company the size of Company E.

<u>Importance of particular adjustments</u>

Even though the "Net Gain or Loss from Operations per the Convention Blank" is the income item emphasized in reports to stockholders, the "Net per Convention Blank Before Items Classed as Dispositions of Income" is the

earnings computation which is concentrated on in this study when the impact of the adjustments on the entire reporting system is analyzed. It is the Convention Blank earnings referred to in the remainder of this discussion. This earnings figure is used because it is the item against which the adjustments are applied and because it includes capital gains in the concept of income. Capital gains are an integral part of the operations of many life insurance companies.

The importance of particular adjustments varies widely from company to company, but the two which have the most significant effect on earnings, as identified in the preceding paragraph, of most of the companies analyzed are those returning corporation stocks from market value to cost, and the capitalization and amortization of first-year life insurance commissions. For many of the small and medium-sized firms studied, these two adjustments have nearly offset each other during recent years. This will be true in the future only if the change in market price of a company's stock parallels the change in volume of insurance written. Should a drop in the stock market occur in a year in which life insurance volume increases, there could be a wide difference between the Convention Blank earnings and earnings computed in conformance with generally accepted accounting principles in those firms.

The relative effect of the two adjustments discussed in the preceding paragraph on a particular company depends on its investment practices and type of insurance written. If a firm has no stocks in its investment portfolio, but emphasizes individual life insurance policies which pay large first-year commissions to agents, the adjustments will substantially increase earnings whenever volume is expanding. On the other hand, a firm

which includes the maximum portion of common stocks in its portfolio but writes mostly accident and health or group insurance will likely find that the adjustments reduce earnings in years in which the stock market is rising.

Effect on balance sheet

Earnings are not the only aspect of the financial statements affected by the adjustments. Even though the adjustments almost cancel each other so far as the computation of annual earnings is concerned in some of the companies, the cumulative adjustment from prior years has a material effect on retained earnings and on the relationship between policyholder reserves and the revenue-producing assets shown in the extended balance sheet of some of the companies studied. For example, the aggregate adjustment to earnings of Company Q is only $1.2 million over the five-year period analyzed, but the cumulative adjustment to retained earnings at the beginning of the test period is $22 million against an unassigned legal surplus of $38 million.

Recommendation

Probably the most important recommendation which can be derived from the test of the materiality and significance of the adjustments is that care must be taken not to let lack of major impact of the adjustments on annual earnings of a few well-established, stable companies divert attention from the need for improved statements in other companies. The need is not dependent upon the size of the company. The greatest need for full reports of accountability is in those firms where changes are taking place which need evaluation. These changes naturally occur in new firms, but also occur in all firms where volume, product-mix, investment policies or reserve valuation methods are not fully stabilized. These are the very firms for which the adjustments tend to be the most significant.

THE REVISED AND EXTENDED FINANCIAL STATEMENTS

The financial statements to which the Convention Blank statements are extended are research tools only and are admittedly technically imperfect and perhaps too complicated for adoption in practice in their present form. It is believed, however, that if technical problems can be solved at the company level, statements simplified from those used in this study could be accompanied by a full, or clean, certificate by an independent certified public accountant. A few of the essential features of these statements which make them superior to the regulatory statements for stockholder purposes are mentioned in the next few paragraphs.

Balance sheet

The extended balance sheet contains all of the assets rather than just the admitted assets, and reports both the National Association of Insurance Commissioners prescribed valuations and the amount invested in each asset. All of the important figures from the Convention Blank are retained, including the exact legal surplus. In addition, the statements indicate the source and amount of all funds made available to management and the way those funds have been invested in assets. It is, therefore, a full report of financial accountability. Although complicated, the balance sheets used in this study provide something no other industry has--a statement which reflects both the accountability which is inherent in generally accepted accounting principles, and a computation of legal surplus which comprises the regulatory balance sheet. Descriptive captions are used which indicate the nature of the accounts.

It is often said that the classification of assets into current and fixed categories is not meaningful in insurance. The balance sheets used

in this report indicate that this may not be a valid assertion. The policyholder reserves are listed at the top of the liabilities section and the revenue-producing assets at the top of the assets section. These are extra items which are not present in the balance sheets of commercial and industrial firms. Once this is recognized, it is possible to construct a traditional balance sheet with the remaining assets and liabilities. The only major change is that assets must be divided into "admitted" and "non-admitted" classifications. This division is necessary in order to compute legal surplus, but is also an effective way of warning the reader that insurance balance sheets have special characteristics derived from the nature of insurance operations which must be considered before the statements can be properly interpreted. The format used reveals at a glance whether any part of net working capital, home office buildings, and other operating assets are purchased out of policyholder reserves or if they are provided entirely by profits and funds contributed by stockholders. This type of information might also be of interest to policyholders in a mutual company.

Two balance sheet accounts are worth reviewing briefly as illustrations of contrasts between insurance company statements and statements which conform with generally accepted accounting principles. One is the Mandatory Securities Valuation Reserve. It was established to temper fluctuations in the legal surplus account. Surplus is reduced and the reserve is increased for all capital gains, net of income tax thereon, as well as by stipulated percentages of different classes of securities owned. All realized and unrealized capital gains are entered directly to the Summary of Surplus schedule in the Convention Blank, but, after reduction for income taxes paid, move immediately to the Mandatory Securities

Valuation Reserve until that reserve reaches the statutory maximum. In view of the nature of these transactions, the Mandatory Securities Valuation Reserve is treated as an appropriation of retained earnings in the extended balance sheets. It qualifies as a liability in the Convention Blank balance sheet because the law says it is a liability. This is because it is a deduction from assets to arrive at legal surplus.

The second item is not even an account in the insurance accounting system. Under certain conditions of threatened impairment of capital, the state insurance department can authorize the issuance of surplus notes and similar securities. By statute, these securities are not liabilities of the insurance company so are omitted from the Convention Blank financial statements altogether.[1] The notes are subordinated and are closely controlled by the state insurance department, so the regulatory authorities are not concerned that they do not appear in the balance sheet. They already know about them. In statements based on generally accepted accounting principles, such instruments must be shown in the capital section of the balance sheet as one of the sources of funds for which management must account.

Earnings statement

A combined earnings and retained earnings statement in comparative form is used in the statements in this study. This is a more meaningful presentation than that afforded by either the current operating or the clean surplus concept with a separate retained earnings summary. The current

---

[1]The existence of these notes is revealed in one of the questions in the Interrogatories portion of the blank. Some state insurance departments also go beyond the requirements of the blank and insist on footnote disclosure in the balance sheet.

operating concept used in the Convention Blank is not appropriate for life insurance reports to stockholders because an annual reporting period is far too short a portion of the operating cycle of most life insurance companies to provide a satisfactory measure of "normal" operations. The best presentation of life insurance company earnings is a comparative aggregation over a period of years. Each year can then be viewed as a measurement of the flow of earnings into the aggregate during the period rather than as a unit standing by itself.

Another factor which makes the current operating concept inappropriate for life insurance companies is the treatment of capital gains. When investment activities are as important and integral a part of the operations of a firm as they are in life insurance companies, it is unrealistic to show interest and dividends as operating income and the capital gains as a non-operating credit to retained earnings or surplus as is done in the Convention Blank. Similarly, entering capital gains in the Summary of Surplus but deducting all of the income taxes as an operating expense is not an acceptable procedure under accounting principles. The statements used in this report avoid these difficulties and provide a significantly more complete and meaningful report from the stockholders' point of view than the statements on Page 4 of the Convention Blank.

Income taxes

Since income tax returns are not available, no effect is given to either the taxes which may eventually be payable on the income deferred from taxation in the Phase III "policyholder surplus" or to the eventual tax effect of the changes in income made by the adjustments. Before the statements can truly be said to conform with generally accepted accounting

principles, these taxes must be adequately disclosed. Whether formal allocation in the accounts is practical, or if footnote disclosure is the best that can be achieved, cannot be affirmatively stated without special research involving access to the tax returns and worksheets of the companies.

Compliance with statutes

Simplified and perfected financial statements containing the principal features of those developed in this study may or may not be permissible under statutes which require all published statements to "correspond with or include the corresponding items from its verified statement made to the Department of Insurance." If not permitted, a change is needed in the statutes.

SUMMARY

Stockholders do not receive as complete information from their life insurance companies as they do from other companies when the only financial statements included in the annual reports are the special purpose statements from Pages 2, 3 and 4 of the Convention Blank. Even though this Convention Blank is a uniform report, the statements themselves are not uniform because the companies are permitted wide ranges of discretion in computing the figures for that report. The companies for which the extended and revised statements are most needed are the very ones for which present statements are the most inadequate. Lack of major impact of the adjustments on the statements of stable, well-established companies must not be allowed to divert attention from the need for better statements from other companies.

With the exception of acquisition costs of life insurance policies, there is sufficient information either already in the detailed schedules of the Convention Blank or readily available to the companies to permit

extension of the Convention Blank statements to conform with generally accepted accounting principles. Proper handling of direct acquisition costs might require minor modification of accounting methods, but the impact of these costs is so material that experimentation and research by the companies is clearly warranted and strongly recommended.

Until statements which conform with generally accepted accounting principles are included in annual reports to stockholders, care must be taken to remind stockholders and other public users of the financial statements of the differences between life insurance company financial statements and the statements in the other reports received by stockholders. This requires qualification or disclaimer of opinion by independent public accountants and imposes a moral duty on the officials of the companies to make full disclosure of these differences.

BIBLIOGRAPHY OF

WORKS CITED AND MAJOR SOURCES

CONSULTED

Books, Monographs and Pamphlets

American Accounting Association. Accounting and Reporting Standards for Corporate Financial Statements and Preceding Statements and Supplements. Columbus, Ohio: American Accounting Association, 1957.

American Institute of Accountants. Audits of Corporate Accounts. New York: American Institute of Accountants, 1934.

American Institute of Certified Public Accountants. Accounting Research and Terminology Bulletins, Final edition. New York: American Institute of Certified Public Accountants, 1961.

American Institute of Certified Public Accountants. Auditing Standards and Procedures, Statements on Auditing Procedure No. 33. New York: American Institute of Certified Public Accountants, Inc., 1963.

Anderson, Corliss D. Corporate Reporting for the Professional Investor. Auburndale, Massachusetts: The Financial Analysts Federation, 1962.

Arthur Andersen & Co. Accounting and Reporting Problems of the Accounting Profession, Second edition. Arthur Andersen & Co., 1962.

Association of Life Insurance Counsel. Life, Health and Accident Insurance Law, Index to Papers and Articles 1913-1962. New York: The Association of Life Insurance Counsel, 1963.

Backer, Morton (editor). Handbook of Modern Accounting Theory. Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1955.

Beardsley, Charles M. Life Company Annual Statement Handbook. Winston-Salem, North Carolina: Security Life and Trust Company, 1962.

Berle, Adolf A. Studies In The Law of Corporation Finance. Chicago: Callaghan and Company, 1928.

Berle, Adolf A. and Means, Gardiner C. The Modern Corporation and Private Property. New York: The Macmillan Company, 1934.

Best's Life Insurance Reports. New York: Alfred M. Best Company, Inc., revised annually.

Blair, B. Franklin. Interpreting Life Insurance Annual Reports. Bryn Mawr, Pennsylvania: The American College of Life Underwriters, 1960.

Blyth and Co. The Insurance Stock Survey, 1963 Issue.

Brimmer, Andrew F. Life Insurance Companies in the Capital Market. East Lansing, Michigan: Bureau of Business and Economic Research, Michigan State University, 1962.

Brown, Richard. A History of Accounting and Accountants. Edinburgh: T. C. & E. C. Jack, 1905.

Brown, R. Gene and Johnston, Kenneth S. Paciolo on Accounting. New York: McGraw-Hill Book Company, Inc., 1963.

Center, Charles C. and Heins, Richard M. Insurance and Government. New York: McGraw-Hill Book Company, Inc., 1962.

Dawson, Miles Menander. Principles of Insurance Legislation. New York: The Humboldt Library, 1895.

Denenberg, Herbert S., Eilers, Robert D., Hoffman, C. Wright, Kline, Chester A., Melone, Joseph J. and Snider, H. Wayne. Risk and Insurance. Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1964.

Edwards, James Don. History of Public Accounting in the United States. East Lansing, Michigan: Bureau of Business and Economic Research, Michigan State University, 1960.

Edwards, James Don and Salmonson, Roland F. Contributions of Four Accounting Pioneers. East Lansing, Michigan: Bureau of Business and Economic Research, Michigan State University, 1961.

Finney, H. A. and Miller, Herbert E. Principles of Accounting, Advanced, Fifth edition. Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1960.

Finney, H. A. and Miller, Herbert E. Principles of Accounting, Intermediate, Fifth edition. Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1958.

First Boston Corporation, The. Data On Selected Life Insurance Company Stocks, Eleventh annual edition. 1963.

Formoy, Ronald Ralph. The Historical Foundations of Modern Company Law. London: Sweet and Maxwell, Limited, 1923.

Fortune Directory, The 500 Largest U. S. Industrial and the 50 Largest Banks, Merchandising, Transportation, Life-Insurance and Utility Companies, and the 200 Largest Foreign Corporations, revised annually. New York: Time, Inc.

Fraine, Harold G. Valuation of Securities Holdings of Life Insurance Companies. Homewood, Illinois: Richard D. Irwin, Inc., 1962.

Graham, Benjamin, Dodd, David L., and Cottle, Sidney. Security Analysis, third edition. New York: McGraw-Hill Book Company, Inc., 1962.

Green, Wilmer. History and Survey of Accountancy. Brooklyn, New York: Standard Text Press, 1930.

Hills, George S. The Law of Accounting and Financial Statements. Boston: Little, Brown and Company, 1957.

Holmes, Arthur W., Maynard, Gilbert P., Edwards, James Don and Meier, Robert A. Intermediate Accounting. Homewood, Illinois: Richard D. Irwin, Inc., 1958.

Joint Committee on Blanks of the Life Insurance Association of America and the American Life Convention. Discussion of Revised Form of Annual Statement for Life Insurance Companies. New York: Life Insurance Association of America, 1947.

Karrmann, E. M. Life Insurance Recordkeeping and Accounting. New York: Life Office Management Association, 1960.

Kedzie, Daniel P. Consumer Credit Insurance. Homewood, Illinois: Richard D. Irwin, Inc., 1957.

Kehl, Donald. Corporate Dividends. New York: The Ronald Press Company, 1941.

Kelsey, R. Wilfred and Daniels, Arthur C. Handbook of Life Insurance, Second edition. New York: Institute of Life Insurance, 1949.

Larson, Robert G. and Gaumnitz, Erwin A. Life Insurance Mathematics. New York: John Wiley & Sons, Inc., 1951.

Lengyel, S. J. Insurance Companies' Accounts. Melbourne and London: F. W. Cheshire Pty. Ltd., 1947.

LeVita, M. H. An Arithmetic of Life Insurance. New York: Life Office Management Association, 1936.

Life Insurance Association of America. Life Insurance Companies as Financial Institutions. Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1962.

Life Insurance Fact Book. New York: Institute of Life Insurance, Revised annually.

Littleton, A. C. Accounting Evolution to 1900. New York: American Institute Publishing Co., Inc., 1933.

Littleton, A. C. Essays on Accountancy. Urbana: University of Illinois Press, 1961.

Littleton, A. C. Structure of Accounting Theory. Urbana, Illinois: American Accounting Association, 1953.

Littleton, A. C. and Yamey, B. S. Studies in the History of Accounting. Homewood, Illinois: Richard D. Irwin, Inc., 1956.

Littleton, A. C. and Zimmerman, V. K. Accounting Theory: Continuity and Change. Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1962.

Maclean, Joseph B. Life Insurance, Ninth edition. New York: McGraw-Hill Book Company, Inc., 1962.

Maclean, Joseph B. and Marshall, Edward W. Distribution of Surplus. New York: The Actuarial Society of America, 1937.

McGill, Dan M. Life Insurance. Homewood, Illinois: Richard D. Irwin, Inc., 1959.

McLaren, N. Loyall. Annual Reports to Stockholders. New York: The Ronald Press Company, 1947.

May, George O. Financial Accounting. New York: The Macmillan Company, 1943.

May, George O. Memoirs and Accounting Thought, edited by Paul Grady. New York: The Ronald Press Company, 1962.

May, George O. Twenty-five Years of Accounting Responsibility. New York: American Institute Publishing Company, Inc., 1936. Vols. 1 and 2 bound together.

Mehr, Robert I. and Osler, Robert W. Modern Life Insurance, Third edition. New York: The Macmillan Company, 1961.

Meigs, Walter B., Johnson, Charles E. and Keller, Thomas F. Intermediate Accounting. New York: McGraw-Hill Book Company, Inc., 1963.

Michelbacher, Multiple-line Insurance. New York: McGraw-Hill Book Company, Inc., 1957.

National Association of Insurance Commissioners. Valuation of Securities. Chicago: The Association, Revised annually.

Patterson, Edwin Wilhite. The Insurance Commissioner in the United States. Cambridge: Harvard University Press, 1927.

Paton, William A. Corporation Accounts and Statements. New York: The Macmillan Company, 1955.

Paton, W. A. and Littleton, A. C. An Introduction to Corporate Accounting Standards. Columbus, Ohio: American Accounting Association, 1940.

Paton, William A. and Paton, William A. Jr. Asset Accounting. New York: The Macmillan Company, 1952.

Sanden, Thomas Henry, Hatfield, Henry Rand and Moore, Underhill. A Statement of Accounting Principles. New York: American Institute of Accountants, 1938, (reprinted by American Accounting Association, 1959).

Securities and Exchange Commission. Special Study on Securities Markets. Washington: United States Government Printing Office, 1963.

Stacey, Nicholas A. H. English Accountancy, A Study in Social and Economic History, 1800-1954. London: Gee and Company, Ltd., 1954.

Staub, Walter A. Auditing Developments During the Present Century. Cambridge, Massachusetts: Harvard University Press, 1942.

Storey, Reed K. The Search for Accounting Principles: Today's Problems in Perspective. New York: American Institute of Certified Public Accountants, Inc., 1964.

Straub, Adelbert G. Examination of Insurance Companies. New York: New York Insurance Department. 7 volumes, 1953 to 1955.

Surrey, Sterling. The Development of the Convention Form of Life Insurance Statement. Philadelphia: Unpublished dissertation at University of Pennsylvania, 1950.

Temporary National Economic Committee. Statement on Life Insurance, Monograph No. 28-A. Washington: United States Government Printing Office, 1941.

Temporary National Economic Committee. Study of Legal Reserve Life Insurance Companies, Monograph No. 28. Washington: United States Government Printing Office, 1940.

Texas Society of Certified Public Accountants. Examination of Texas Chartered Insurance Company Financial Statements by Independent Certified Public Accountants. Dallas: The Texas Society of Certified Public Accountants, 1956.

Texas Society of Certified Public Accountants, Insurance Examination Committee. A Brief Introduction to the Financial Statements and Taxation of Life Insurance Companies. May, 1963 (mimeographed).

Welsch, Glenn A., Zlatkovich, Charles T. and White, John Arch. Intermediate Accounting. Homewood, Illinois: Richard D. Irwin, Inc., 1963.

Wightman, E. C. Budgetary Control In Life Insurance Management. New York: Life Office Management Association, 1954.

Wightman, E. C. Life Insurance Accounts, Second edition. New York: Life Office Management Association, 1941.

Wightman, E. C. Life Insurance Statements and Accounts. New York: Life Office Management Association, 1952.

Wixon, Rufus and Kell, Walter G. (editors). Accountant's Handbook. New York: The Ronald Press Company, 1956.

Articles, Reports and Chapters in Books or Manuals

Allyn, W. Ellery. "Presidential Address," Proceedings of National Association of Insurance Commissions, Eighty-second session, 1951, 18-24.

American Life Convention, Life Insurance Ass'n. of America and Life Insurers Conference. "Statement to Subcommittee on Securities of Senate Banking and Currency Committee," Also Reported in The National Underwriter, June 29, 1963.

American Life Convention. "State Supervision of Insurance and the National Association of Insurance Commissioners." Statement filed for the Record of the Temporary National Economic Committee--Proceedings of the National Association of Insurance Commissioners, Seventy-first session, 1940, 143-168.

"Amortization of Bonds, Resolution Regarding," Proceedings of the National Convention of Insurance Commissioners, Forty-ninth session, 1918, 18.

Anderson, B. M. "American Life Convention - Life Association of America Subcommittee on Deficiency Reserves, Statement Before Life Insurance Committee of the National Association of Insurance Commissioners," Proceedings of National Association of Insurance Commissioners, 1957, V. I, 132-133.

Angle, John C. "Reserves," Chapter 12 of Faulkner, Edwin J. Health Insurance. New York: McGraw-Hill Book Company, Inc., 1960.

Anthony, Robert N. "Showdown on Accounting Principles," Harvard Business Review, V. 41, No. 3 (May-June, 1963), 99-106.

Appleton, Henry D. "Wherein Have Insurance Conditions Improved During the Past Twenty Years In The Field of Life Insurance," Proceedings of the National Convention of Insurance Commissioners, Forty-sixth session, 1915, 93-101.

Barr, Andrew. "Financial Reporting for Financial Agencies," Journal of Accountancy, V. 105 (Feb., 1958), 26-32.

Beha, James A. "Acquisition Cost Control," Proceedings of the National Convention of Insurance Commissioners, Fifty-seventh session, 1926, 239-253.

Berry, S. N. "Presidential Report," Proceedings of the National Association of Insurance Commissioners, Regular Meeting, 1961, V. I, 31-35.

Button, Joseph. "Should the Item of Accrued Taxes In Reports Be Treated as a Liability," Proceedings of National Association of Insurance Commissioners, Thirty-ninth session, V. I, 1908, 164-166.

Carr, Cecil Thomas. "Early Forms of Corporateness," in Select Essays in Anglo American Legal History, Volume 3. Cambridge: Little, Brown and Company, 1909, 161-182.

Chambers, R. J. "Function of the Balance Sheet," Chartered Accountant in Australia, V. 27 (April, 1957).

Cleary, M. J. Letter to Mr. Grady H. Hepp, Actuary, Insurance Department, Albany, New York. Proceedings of the National Convention of Insurance Commissioners, Fifty-fifth session, 1924, 170-171.

"Constitutional Law - Insurance Regulation - Extraterritorial Jurisdiction of States," Case Notes, De Paul Law Review, V. 12, No. 1 (Autumn - Winter 1962) 138-145.

Craig, James E. Remarks following paper by Mr. Hammond. Proceedings of the National Convention of Insurance Commissioners, Fifty-fifth session, 1924, 168-169.

Dawson, Miles M. "The Development of Insurance Mathematics," Chapter VII of Yale Readings in Insurance - Life and Accident, edited by Lester W. Zartman and William H. Price. New Haven: Yale University Press, 1914, 95-119.

DeCapriles, Miguel A. "Modern Financial Accounting," New York University Law Review, Part I, V. 37, No. 6 (December, 1962) 1001-1088; Part II, V. 38, No. 1 (January, 1963) 1-66.

Deficiency Reserves Etc., Report of Subcommittee on. Proceedings of the National Association of Insurance Commissioners, 1957, Regular Meeting, V. I, 139-143.

Deficiency Reserves and Mortality Tables Review, Report of Subcommittee on. Proceedings of the National Association of Insurance Commissioners, Regular Meeting, 1959, V. I, 187-196.

de Roover, Florence Edler. "Partnership Accounts in Twelfth Century Genoa," in Studies in History of Accounting, edited by A. C. Littleton and B. S. Yamey. Homewood, Illinois: Richard D. Irwin, Inc., 1956, pp. 86-90.

de Roover, Raymond. "The Development of Accounting Prior to Luca Pacioli According to the Account-Books of Medieval Merchants," in Studies in the History of Accounting, edited by A. C. Littleton and B. S. Yamey. Homewood, Illinois: Richard D. Irwin, Inc., 1961, 114-170.

Digest of Informal Discussion. Transactions of the Society of Actuaries, Meeting No. 8 (1952) 131-144.

Donaldson, Gordon. "Financial Goals: Management vs. Stockholders," Harvard Business Review, V. 41, No. 3 (May-June, 1963) 116-129.

Dumont, John R. "Acquisition Costs of Life Insurance," Proceedings of the National Convention of Insurance Commissioners, Fifty-ninth session, 1928, 170-178.

"Economics of Life Insurance, The," Forbes, V. 93, No. 8 (April 15, 1964) 24-31.

Edwards, James Don. "Early Bookkeeping and Its Development Into Accounting," Business History Review, V. 34 (Winter, 1960) 446-458.

Edwards, James Don. "Public Accounting in the United States from 1928 to 1951," Business History Review, V. 30, No. 2 (September, 1956) 444-471.

Examination Methods, Practices and Laws, Subcommittee on. "Proposed Standard Law Relating to Procedures in Examining the Affairs of Insurance Companies," Proceedings of the National Association of Insurance Commissioners, Semi-annual Meeting, 1956, 113.

Fletcher, Mr. "Comment," The Proceedings of the National Convention of Insurance Commissioners, 1906, 83.

Gain and Loss Exhibit, Report of Subcommittee on. Proceedings of the National Association of Insurance Commissioners, Eightieth session, 1949, 401.

Gold, Melvin L. "Valuing a Life Insurance Company," Transactions of the Society of Actuaries, V. 14, No. 3 (September, 1962) 139-157 and Discussion 158-170.

"Great Boom in Life Insurance Stocks, The," Forbes, V. 93, No. 8 (April 15, 1964) 21-32.

Griffith, Reynolds. "A Note on Life Insurance Accounting," The Journal of Risk and Insurance, V. 31, No. 2 (June, 1964) 207-215.

Hammond, H. Pierson. "The History of the Development of the Gain and Loss Exhibit of Life Companies," Proceedings of the National Convention of Insurance Commissioners, Fifty-fifth session, 1924, 235-263.

Hartigan, John A. "Should the Item of Accrued Taxes In Reports Be Treated As a Liability?" Proceedings of the National Convention of Insurance Commissioners, Thirty-ninth session, 1908, 161-164.

Hearn, Edward G. "Life Insurance - Taxation Aspects of Phase III," The Proceedings of the Conference of Actuaries in Public Practice, V. 10 (1960-1961) 72-98.

Holmes, Horace. "The Standards of Policy Reserves in America and their Effect on the Life Assurance Business," Transactions of Actuarial Society of America, V. 39, No. 99 (May, 1938) 281-296.

Hotchkiss, William H. "Saving in Life Insurance by the Limitations of Expenses Prescribed by the New York Law," Proceedings of the National Convention of Insurance Commissioners, Forty-first session, 1910, 111-126.

Industry Advisory Committee, Report to N.A.I.C. Subcommittee to Analyze and Review Examinations of Insurance Companies - To Perfect Practices and Procedures of Association Examinations. Proceedings of the National Association of Insurance Commissioners, Eighty-ninth Annual Meeting, 1958, 342-343.

"Informal Discussion; Digest Of," Transactions of Society of Actuaries, V. 4, No. 3 (1952) 131-144.

Krowitz, I. M. "Gain and Loss Exhibit," in Examination of Insurance Companies, edited by Adelbert G. Straub. New York: New York Insurance Department, 1954, IV, 319-361.

Lee, Laurence F. Taxation of Life Insurance Income - Hearings Before Committee on Finance, United States Senate, on H.R. 10021, 85th Congress, Second session, March 5 and 6, 1958, 118.

Leggett, C. Lawrence. Presidential Address, Proceedings of the National Association of Insurance Commissioners, Eighty-seventh Annual Meeting, 1956, V. I, 32-34.

Leslie, Charles K., Jr. "In Search of a Pattern for Company Management in Early Years," Proceedings of the Conference of Actuaries in Public Practice, V. 11 (1961-1962) 92-114.

Littleton, A. C. "Principles Under Challenge," New York Certified Public Accountant, V. 24 (January, 1954) Reproduced in Essays on Accountancy. Urbana: University of Illinois Press, 1961, 405-410.

Littleton, A. C. "Variety in the Concept of Income," New York Certified Public Accountant, V. 23, No. 7 (July, 1953) Reproduced in Essays on Accountancy. Urbana: University of Illinois Press, 1961, 287-293.

Lytle, Richard C. "Audit Reports on Insurance Companies," Journal of Accountancy, V. 117, No. 1 (January, 1964) 74-75.

McCall, John A. "The Scope and Grounds of State Supervision of Life Insurance in the United States," Proceedings of the National Convention of Insurance Commissioners, 1902, 74-90.

Mallon, Edward J. "Financial Statements for Life Insurance Companies," The New York Certified Public Accountant, V. 23 (February, 1953) 109-118.

May, George O. "Principles of Accounting," The Journal of Accountancy, V. 64, No. 6 (December, 1937)

Mayerson, Allen L. "Dividends: Life Companies," Ch. 12 of V. 3 of Examination of Life Insurance Companies, edited by Adelbert G. Straub. New York: New York Insurance Department, 1954, 603-634.

Merrill, Robert J. "The Best Way of Obtaining Correct Annual Statements," Proceedings of the National Convention of Insurance Commissioners, Forty-seventh session, 1916, 219-221.

Miller, Herbert E. "After There is Agreement on Broad Accounting Principles - What Then?" The Texas CPA, V. 34 (September, 1961) 3-6.

Morris, Edward N. F. "Credit Group Life Insurance," Proceedings of the Conference of Actuaries in Public Practice, V. 6 (1956-1957) 91-96.

Murphy, R. D. Comments. Transactions, Society of Actuaries, V. IV, Meeting 8 (1952) 143.

Mutual Life Insurance Company. "Net Valuation," Chapter XV of Yale Readings in Insurance, edited by Lester W. Zartman and William H. Price. New Haven: Yale University Press, 1914, 208-222.

National Association of Insurance Commissioners, Chicago, September 30, 1957, Minutes of Meeting of Deputies, Actuaries and Chief Examiners, Zone IV.

Need for a New Mortality Table and Related Topics, Special Committee to Study. Supplement to Proceedings of the National Association of Insurance Commissioners, Seventy-first session, 1940.

Pedoe, Arthur. "Further Notes on the Trend of Life Insurance Company Expenses," Transactions of the Society of Actuaries, V. 13, No. 3 (September, 1961) 1-19 and Discussion 20-30.

Pedoe, Arthur. "The Trend of Life Insurance Company Expenses," Transactions of the Society of Actuaries, V. 4, No. 1 (January, 1953) 485-503 and Discussion 504-510.

Peloubet, Maurice E. "The Historical Background of Accounting," in Handbook of Modern Accounting Theory, edited by Morton Backer. New York: Prentice-Hall, Inc., 1955.

Phillips, H. L. "The Consolidation of Life and Casualty Companies," Proceedings of the National Convention of Insurance Commissioners, Forty-sixth session, 1915, 236-239.

Pike, Bertram N. "Gain and Loss Analysis and Related Concepts for Group Insurance," Transactions of Society of Actuaries, V. 13 (March, 1962) 412-424 and Discussion 425-426.

Preservation of State Regulation, Committee on. "State Regulation of Insurance," (Statement submitted to the United States Senate, Committee on the Judiciary, Subcommittee on Antitrust and Monopoly), Proceedings of National Association of Insurance Commissioners, 1960, Regular Meeting, V. I, 53-131.

Prudential Insurance Company - "The Cost of Credit Life, Health and Accident Insurance," - memorandum to committee on Installment Sales and Loans of the National Association of Insurance Commissioners. Proceedings, Eighty-eighth Annual Meeting, 1957, V. I, 150-154.

Rappaport, Louis H. "Forces Influencing Accounting; The Stock Exchanges," Lybrand Journal, V. 44, No. 1 (1963).

Resolution regarding Accounting Principles Board. The Journal of Accountancy, V. 117, No. 6 (June, 1964) 9.

Rittenhouse, E. E. "Address," Proceedings of National Convention of Insurance Commissioners, Thirty-ninth session, 1908, 200-211.

Robbins, Rainard B. "Reserve Standards for Life Insurance," Transactions of Actuarial Society of America, V. 24 (1923) 312-324.

Sarason, Harry M. "Life Insurance Auditing," Proceedings of the Conference of Actuaries in Public Practice, V. 6 (1956-57) 40-59.

Sarason, Harry M. "Report of the Committee on Legal Reserve Life Statements," The Proceedings of the Conference of Actuaries in Public Practice, V. 6 (1956-57) 393-398.

Sears, Marian V. "The American Businessman at the Turn of the Century," Business History Review, V. 30, No. 2 (September, 1956) 382-443.

Shepherd, C. O. "The 'Convention' Statement of Life Insurance Companies," The Record of the American Institute of Actuaries, V. 26, No. 53 (1937) 105-192.

Silletto, Charles D. Comments in Discussion on Topics of Current Interest, Transactions of the Society of Actuaries, 1961, No. 3 (September, 1961) D150-D151.

Smith, C. A. "Speculations on Roman Influence on the Theory of Double Entry Book-keeping," Accounting Research, V. 5, No. 4 (October, 1954) 335-342.

Smith, Gustavus W. "Reserve," Chapter XIV of Yale Readings in Insurance, edited by Lester W. Zartman and William H. Price. New Haven: Yale University Press, 1914, 135-155.

Storey, Reed K. "Accounting Principles: A.A.A. and AICPA," Journal of Accountancy, V. 117, No. 6 (June, 1964), 47-55.

Taylor, Robert B. "President's Report," Proceedings of the National Association of Insurance Commissioners, Eighty-eighth Annual Meeting, 1957, V. II, 263-265.

Union Central Life Special Committee Report - Proceedings of the National Convention of Insurance Commissioners, Forty-second session, 1911, Vol. I, 172-175.

Van Fleet, George. "Some Problems of the Young Company," The Proceedings of the Conference of Actuaries in Public Practice, V. 11 (1961-62).

Vatter, William J. "Postulates and Principles," Journal of Accounting Research, V. 1, No. 2 (Autumn, 1962) 179-197.

Vorys, Mr. "Comment," The Proceedings of the National Convention of Insurance Commissioners, 1906, p. 69.

Walker, J. Barrett. "A Practical Method of Forecasting a Life Insurance Company's Gross Operating Earnings for the Current Year," Transactions of the Society of Actuaries, V. VII (August, 1955) 31-52.

Weiner, Joseph L. and Bonbright, James C. "Theory of Anglo-American Dividend Law," Columbia Law Review, V. 30 (1930) 330-358; 954-985.

Wells, George W., Jr. "Discussion of paper by Mr. Dumont," Proceedings of the National Convention of Insurance Commissioners, Fifty-ninth session, 1928, 109-112.

Weintz, William W. and Richard, Edmund B. "Requirements of the Securities and Exchange Commission," Chapter 38 of Contemporary Accounting, edited by Thomas W. Leland. New York: The American Institute of Accountants, 1945.

Wheeler, Roy A. "Should The Gain and Loss Exhibit be Revised," Proceedings of the National Conference of Insurance Commissioners, 1919, pp. 268-271.

Zartman, Lester W. "Mistakes in State Regulation of the Insurance Business," Yale Review, V. 17 (May, 1908) 24-43.

Statutes and Court Cases

Bankers Life Insurance Co. vs. Howland, 73 Vt. 1, 48 Atl. 435.

Randall vs. Bailey, 23 N.Y.S. 2d. 173; Aff'd. 228 N.Y. 280, 43 N.E. 2d. 43.

Revised Statutes of Nebraska, Chapter 44 - "Insurance."

Appendix I
Table 7

Table 7: Underwriting and Other Statistics on The Foreign Companies Analyzed

	Company									
	M	N	O	P	Q	R	S	T	U	V
Premiums:										
Total 1962 premiums	$ 66 mil.	$ 51 mil.	$ 72 mil.	$ 34 mil.	$ 110 mil.	$ 137 mil.	$ 178 mil.	$ 247 mil.	$ 398 mil.	$ 853 mil.
Percentage increase since 1957	38.8%	66.8%	56.1%	8.2%	38.1%	35.6%	33.2%	32.8%	32.5%	26.6%
Percentage increase since 1952	117.6	231.7	134.1	27.7	126.1	86.9	93.0	93.4	114.4	127.0
Distribution of 1962 premiums:										
Ordinary life	45.6	97.7	34.3	96.2	93.1	52.8	35.6	61.9	30.4	15.1
Ordinary annuities	.7	.2		.9	4.6	.7	.1	.8	1.1	.3
Industrial						28.7	45.1			
Group life	4.6	2.1	17.4	.1		3.6	.2	7.7	12.6	21.9
Group annuities						.8	.2	.9	18.0	12.6
Accident and health	47.3		46.1			11.7	16.5	26.6	37.0	49.7
Other lines	1.8			2.8	2.3	1.7	2.3	2.1	0.9	.4
Life Insurance Written in 1962:										
Total written	$ 576 mil.	$ 438 mil.	$ 390 mil.	$ 180 mil.	$1,158 mil.	$1,668 mil.	$1,413 mil.	$1,993 mil.	$2,034 mil.	$2,499 mil.
Distribution:										
Whole life and endowment	29.6%	74.9%	19.5%	54.8%	27.4%	33.9%	57.3%	29.0%	27.6%	16.4%
Term	61.2	23.1	35.7	45.2	72.6	20.8	2.7	53.6	19.1	11.0
Group	9.2	2.0	44.8			32.6	.4	17.4	53.3	72.6
Industrial						12.7	39.6			
Insurance in Force December 31, 1962:										
Total in force	$2,463 mil.	$2,226 mil.	$3,647 mil.	$1,521 mil.	$4,793 mil.	$6,431 mil.	$6,628 mil.	$12,016 mil.	$13,332 mil.	$27,209 mil.
Distribution:										
Whole life and endowment	37.0%	75.1%	18.3%	80.9%	47.2%	43.8%	50.4%	45.1%	29.0%	15.1%
Term	46.4	17.6	27.2	19.0	52.8	13.9	4.8	32.8	9.4	3.3
Group	16.6	.7	54.5	.1		20.0	1.3	22.1	61.6	81.6
Industrial						22.3	43.5			
Percentage growth 1957-62:										
Whole life	68		29	17	41	58	16	19	49	17
Term	99		72	38	112	26	136	46	50	71
Group	83		96	(34)		98	23	79	41	32
Industrial						3.3	3			
Value	79		63	19	60	37	32	28	50	25
Market Value of Stock:										
Percentage increase 1953 high to early 1963[a]	992		689	366	948	371	472	320	659	358
Percentage increase 1958 high to early 1963 high[a]	199		170	111	164	83	118	83	98	95

Sources: For all except Company N, Blythe & Co., The Insurance Stock Survey, 1963 Issue, and The First Boston Corporation, Data on Selected Life Insurance Company Stocks, Eleventh annual edition, 1963. Company N is not covered by either of these surveys because its stock is not publicly held, so data was computed from information in the Convention Blanks, and from Alfred M. Best Company, Inc., Best's Life Insurance Reports and Moody's Banks, Insurance, Real Estate and Investment Trusts.

[a]Adjusted for stock splits and stock dividends.

Life Insurance Company F
Work Sheet Used to Extend Convention Blank Statements to Conform With "Generally Accepted Accounting Principles"
Year Ended December 31, 1962

	Convention Blank		Cumulative Adjustments		Current Adjustments		Extended Balance Sheet		Summaries References & Comments
	Assets	Liabilities	Dr	Cr	Dr	Cr	Dr	Cr	
Assets:									
Bonds	$223,717,608.28		$ 87,500.00			(20) $ 27,500.00	$223,777,608.28		D-1(4)
Write up of Canadian Bonds						(8) 326,313.31		$ 326,313.31	$223,451,294.97
Stocks	43,911,558.38			$14,831,375.32	(21) $ 1,206,688.68		30,286,871.74		D-2(7)
Mortgage loans on real estate	100,164,430.86						100,164,430.86		
Properties occupied by the company	9,169,685.07		(A) 3,858,921.03		(A) 418,906.31		13,447,512.41		
Cumulative depreciation on property occupied by the Company				(A) 3,858,921.03		(A) 418,906.31		4,277,827.34	
Properties acquired in satisfaction of debt	8,080.31						8,080.31		13,289,057.33
Investment real estate	4,111,291.95		(A) 2,497,503.10		(B) 169,131.23		6,777,926.28		
Cumulative depreciation on investment real estate				(A) 2,497,503.10		(B) 169,131.23		2,666,634.33	
Policy loans	26,060,528.87						26,060,528.87		
Guaranteed premium notes and interest	1,296.17						1,296.17		
Cash and bank accounts	2,672,938.40						2,672,938.40		
Managers annuity account	1,099.33						1,099.33		
Amounts receivable from reinsurers	2,680.00						2,680.00		104,694.03
Premiums in course of collection--admitted portion	102,014.03						102,014.03		2,853,243.33
Life insurance premiums and annuity considerations deferred and uncollected	11,037,845.06						11,037,845.06		$ 2,957,937.36
Interest and other investment income due and accrued	2,853,243.33						2,853,243.33		
Electronic data processing equipment	401,521.72		1,619,892.86		(52) 414,773.73	(C) 1,636,188.31	800,000.00		
Cumulative depreciation--electronic data processing equipment				941,268.70	(D) 784,625.38	(52) 241,834.96		398,478.28	13-12.3
Furniture and equipment					(C) 1,636,188.31		1,636,188.31		
Cumulative depreciation--furniture and equipment						(D) 784,625.38		784,625.38	
Separate account business	189,330.54						189,330.54		
Agents' debit balances			183,075.35			(4) 11,160.77	171,914.58		13-12.1
Bills receivable			21,349.49			(7) 3,724.49	17,625.00		13-12.2
Travel expense advances					(3) 8,953.08		8,953.08		13-12.6
Premiums in course of collection--non-admitted portion					(14) 16,290.05		16,290.05		13-14
Deferred first-year life insurance commissions			8,308,306.50		(40) 565,673.22		8,873,979.72		W.S. Sch.
Deferred accident and health insurance commissions			195,008.77			(41) 16,528.74	178,480.03		W.S. Sch.
Deferred accident and health insurance direct acquisition costs			1,044.72		(42) 254.88		1,299.60		W.S. Sch.
Deferred past service portion of retirement plan					(63) 360,000.00		360,000.00		

Life Insurance Company F
Work Sheet Used to Extend Convention Blank Statements to Conform With "Generally Accepted Accounting Principles"
Year Ended December 31, 1962

Appendix II

	Convention Blank		Cumulative Adjustments		Current Adjustments		Extended Balance Sheet		Summaries References & Comments
	Assets	Liabilities	Dr	Cr	Dr	Cr	Dr	Cr	
Liabilities:									
Aggregate reserve for life policies and contracts		$331,663,109.00						$331,663,109.00	
Aggregate reserve for accident and health policies		6,008,603.05						6,008,603.05	
Supplementary contracts without life contingencies		4,335,599.00						4,335,599.00	
Policy and contract claims--life		2,362,523.78							
Policy and contract claims--accident and health		1,463,347.00						3,825,870.78	
Policyholders' dividend accumulation		21,646.00						21,646.00	P
Policyholders' dividends due and unpaid		18.33						18.33	
Provision for policyholders' dividends payable in following year:									
Apportioned for payment to 3-1-63		2,375.93						2,375.93	
Not yet apportioned		22,495.38						22,495.38	
Premiums and annuity considerations received in advance		501,049.86						501,049.86	
Liability for premium deposit funds		1,066,417.83						1,066,417.83	
Accumulated savings		57,145.71						57,145.71	P
Provision for experience rating refunds		2,456,298.55						2,456,298.55	R
Coupons on deposit		106,257.74						106,257.74	P
Deposit administration funds		38,716.87						38,716.87	R
Commissions to agents due or accrued:									
Life and annuity		290,107.52						290,107.52	
Accident and health		8,481.00						8,481.00	
General expenses due and accrued		466,694.79						466,694.79	
Taxes, licenses, fees due or accrued		2,130,240.58						2,130,240.58	
Unearned investment income		366,176.18						366,176.18	
Amounts withheld or held by company as agent or trustee		75,709.07						75,709.07	
Agents' credit balances		307,788.49						307,788.49	
Other amounts held for agents' account		27,135.26						27,135.26	
Remittances and items not allocated		479,850.29						479,850.29	
Net adjustment in assets due to foreign exchange rates		490,060.57	$ 91,008.38		(8) $ 399,052.19			-	
Reserve for revision of employees retirement plans		400,000.00						400,000.00	
Separate account clearing		348.79						348.79	

Life Insurance Company F
Work Sheet Used to Extend Convention Blank Statements to Conform With "Generally Accepted Accounting Principles"
Year Ended December 31, 1962

Appendix II

	Convention Blank		Cumulative Adjustments		Current Adjustments		Extended Balance Sheet		Summaries References & Comments
	Assets	Liabilities	Dr	Cr	Dr	Cr	Dr	Cr	
Liabilities (Continued):									
Excess interest on supplementary contracts without life contingencies		$ 5,212.00						$ 5,212.00	R
Reserve for unclaimed funds		6,456.90						6,456.90	R
Mandatory securities valuation reserve		11,911,007.05						11,911,007.05	
Group contingency reserve		664,188.39						664,188.39	
Undistributed funds--home office employees group life insurance		261,488.27						261,488.27	
Territories transferred		330,044.89						330,044.89	R
Unpaid electronic data processing equipment purchased		283,203.00						283,203.00	
Notes payable		122,500.00						122,500.00	
Separate account business		34,964.68						34,964.68	R
Stockholder Investment:									
Capital paid up		1,000,000.00						1,000,000.00	
Unassigned surplus		54,637,890.55	$ 5,265,457.95		(E) $ 8,162,627.65	Bal. $ 2,344,623.56			
		(E)	43,554,428.51						
Premium on capital stock				(E) $ 300,000.00				300,000.00	$ 51,717,056.16
Retained earnings				(E) 43,254,428.51		(E) 8,162,627.65		51,417,056.16	
	$424,405,152.31	$424,405,152.31	$65,683,496.66	$65,683,496.66	$14,143,164.71	$14.143,164.71	$429,448,135.99	$429,448,135.99	

Appendix II

Life Insurance Company F
Work Sheet Used to Extend Convention Blank Statements to Conform With "Generally Accepted Accounting Principles"
Year Ended December 31, 1962

	Convention Blank		Cumulative Adjustments		Current Adjustments		Revised Earnings Statement		Summaries References & Comments
	Expense	Income	Dr	Cr	Dr	Cr	Dr	Cr	
Income:									
Premiums and annuity considerations:									
Life		$55,293,067.70						$55,293,067.70	
Accident and health		5,871,268.24						5,871,268.24	
Consideration for supplementary contracts with life contingencies		316,253.33							
Consideration for supplementary contracts without life								1,084,450.03	
contingencies		768,196.70							
Net investment income		15,964,903.48				(a) $2,314,945.57			
						(f) 9,708.21		18,289,557.26	
Sundry receipts		10,745.76							
Separate account expense allowance		34,161.71						84,376.30	
Deposit administration		39,468.93							
Expenses:									
Death benefits	$14,645,485.35								
Matured endowments	2,116,652.31								
Annuity benefits	1,976,136.51								
Disability benefits	105,675.81								
Surrender benefits	7,679,466.64								
Group conversions	22,536.88								
Benefits under health and							$32,131,223.27		
accident policies	4,305,760.77								
Interest on policy or contract funds	46,058.59								
Payments on supplementary contracts with life contingencies	279,536.43								
Payments on supplementary contracts without life contingencies and for dividend accumulation	953,913.98								
Change in aggregate reserve for policies and contracts with life contingencies	20,400,485.32								
Change in aggregate reserve for									$20,512,042.54
supplemental contracts without							20,512,042.54		6,456.90
life contingencies and dividend accumulation		33,180.10							$20,518,499.44
Increase in deposit administration funds	38,716.87								
Increase in reserve for accident and health policies	106,020.45								
Commissions on premiums and annuity considerations	8,000,253.90				(41) $ 16,528.74	(40) 565,673.22	7,451,109.42		
Cost of territories transferred	8,999.75						7,237,199.44		
General insurance expense	7,188,454.57				(63) 40,000.00	(42) 254.88			

Life Insurance Company F
Work Sheet Used to Extend Convention Blank Statements to Conform With "Generally Accepted Accounting Principles"
Year Ended December 31, 1962

Appendix II

	Convention Blank		Cumulative Adjustments		Current Adjustments		Revised Earnings Statement		Summaries References & Comments
	Expense	Income	Dr	Cr	Dr	Cr	Dr	Cr	
Expenses (Continued):									
Insurance, taxes, licenses and fees	$ 2,936,360.88				(a) $ 240,964.01	(c) $1,663,480.37	$ 1,513,844.52		
Change in loading on and cost of collection in excess of loading on deferred and uncollected premiums		$ 69,473.90						$ 69,473.90	
Increase in reserve for unclaimed funds	6,456.90						6,456.90		
General investment expense					(a) 1,485,944.02 (a) 588,037.54		2,073,981.56		
Dividends to life policyholders	33,127.20						33,127.20		
Totals	$70,850,099.11	$78,400,719.75			$2,371,474.31	$4,554,062.25	$70,958,984.85	$80,692,193.43	
Subtraction of smaller total from larger total		70,850,099.11				2,371,474.31		70,958,984.85	
Net per Convention Blank Income Statement		$ 7,550,620.64				$2,182,587.94		$ 9,733,208.58	
Surplus:									
Capital gains and losses	1,147,381.01				(8) 326,313.31 (20) 27,500.00 (f) 9,708.21	(21) 1,206,688.68 (8) 399,052.19		94,838.34	Ex. 4, L. 11
Prior years expense adjustment		132,176.82						132,176.82	
Special group reserves	134,550.73						134,550.73		
Gain or loss from non-admitted and related items	183,296.64				(4) 11,160.77 (7) 3,724.49	(14) 16,290.05 (3) 8,953.08 (52) 172,938.77 (63) 400,000.00	-		
Employee retirement plan	400,000.00								
Increase in reserve on account of change in valuation basis	311,426.00						311,426.00		
Change in mandatory securities valuation reserve		823,665.65						823,665.65	
Decrease in surplus of separate account business	11,804.64						11,804.64		
Dividends to stockholders	500,000.00						500,000.00		
Federal income taxes					1,663,480.37		1,663,480.37		
Beginning surplus		48,819,886.46	5,265,457.95					43,554,428.51	
	$ 2,688,459.02	$57,326,349.57	$5,265,457.95		$2,041,887.15	$4,386,510.71	$ 2,621,261.74	$54,338,317.90	
Subtraction of smaller total from larger total		2,688,459.02				2,041,887.15		2,621,261.74	
Net--Agrees with balance sheet		$54,637,890.55	$5,265,457.95			$2,344,623.56		$51,717,056.16	

Notes:

a. The work sheets used in the actual analysis have separate columns for adjusting entries and reclassification entries. Space limitations make it necessary to place both in the same columns herein, but numbers are used to identify adjusting entries and letters to identify reclassification entries. The entry numbers correspond with those used in the body of this thesis.

b. Each of the balance sheet accounts which is not in agreement with, or supported by, a Convention Blank figure or schedule are supported by a work sheet analysis. The principal supporting work sheet analyses include: Deferred first-year life insurance commissions, Deferred accident and health insurance commissions, Deferred direct acquisition costs of accident and health insurance, furniture and equipment, and income taxes.

ANNUAL STATEMENT

For the Year Ended December 31, 1962

OF THE CONDITION AND AFFAIRS OF THE

____

____

Organized under the Laws of the State of ______________________, made to the

INSURANCE COMMISSIONER OF THE STATE OF NEBRASKA

PURSUANT TO THE LAWS THEREOF

Incorporated ______________________ Commenced Business ______________________

Home Office ______________________ (Street and Number), ______________________ (City or Town, Zone Number and State)

Mail Address ______________________ (Street and Number), ______________________ (City or Town, Zone Number and State)

OFFICERS

President ______________________

Secretary ______________________

Treasurer ______________________

Vice-Presidents ______________________

Actuary ______________________

DIRECTORS OR TRUSTEES

____

State of ______________________ } ss:
County of ______________________

______________________, President, ______________________, Secretary, ______________________, Actuary,
______________________ Treasurer* of the ______________________, being duly sworn, each for himself deposes and says that they are the above described officers of the said insurer, and that on the thirty first day of December last, all of the herein described assets were the absolute property of the said insurer free and clear from any liens or claims thereon, except as herein stated, and that this annual statement, together with related exhibits, schedules and explanations therein contained, annexed or referred to are a full and true statement of all the assets and liabilities and of the condition and affairs of the said insurer as of the thirty first day of December last, and of its income and deductions therefrom for the year ended on that date, according to the best of their information, knowledge and belief, respectively.

Subscribed and sworn to before me this

______ day of ______________, 1963

____

______________________ President.

______________________ Secretary.

______________________ Actuary.

______________________ Treasurer*.

*Or corresponding persons having charge of the accounts and finances of the insurer.

2

ANNUAL STATEMENT FOR THE YEAR 1962

Form 1

Except for Items 25A and 26, the figures on this page do not include Separate Account items, if any.

OF THE .... COMPANY

(Write or stamp name of Company)

ASSETS

	DOLLARS	CENTS
1. Bonds (Schedule D)		
2. Stocks (Schedule D)		
3. Mortgage loans on real estate (Schedule B)		
4. Real estate (Schedule A)		
4.1 Properties occupied by the Company (less $ .... encumbrances) $		
4.2 Properties acquired in satisfaction of debt (less $ .... encumbrances)		
4.3 Investment real estate (less $ .... encumbrances) ________		
5. Policy loans		
6. Premium notes		
7. Collateral loans (Schedule C)		
8. Cash and bank deposits (Exhibit 13)		
9.		
10.		
10A. Cash and invested assets $ .... (Items 1 to 10)		
11. Amounts recoverable from reinsurers (Schedule S)		
12.		
13.		
14.		
15.		
16.		
17. Life insurance premiums and annuity considerations deferred and uncollected		
18. Accident and health premiums due and unpaid effective after September 30th of current year		
19. Interest and other investment income due and accrued		
20. Net adjustment in assets and liabilities due to foreign exchange rates		
21.		
22.		
23.		
24.		
25.		
25A. Separate Account Business (see Separate Account Statement)		
26. TOTAL		

NOTE: The items on this page to agree with Exhibit 13, Col. 4.

State basis of valuation:

....

....

....

Form 1
Except for Items 25A, 26, 30 and 31, the figures on this page do not include Separate Account items, if any.

ANNUAL STATEMENT FOR THE YEAR 1962

OF THE .... COMPANY

(Write or stamp name of Company)

LIABILITIES, SURPLUS AND OTHER FUNDS

		DOLLARS	CENTS
1.	Aggregate reserve for life policies and contracts (Exhibit 8)		
2.	Aggregate reserve for accident and health policies (Exhibit 9, Part 1)		
3.	Supplementary contracts without life contingencies (Exhibit 10, Col. 5)		
4.	Policy and contract claims		
	4.1 Life (Exhibit 11, Part 1)		
	4.2 Accident and Health (Exhibit 9, Part 2)		
5.	Policyholders' dividend accumulations (Exhibit 10, Col. 6)		
6.	Policyholders' dividends due and unpaid		
7.	Provision for policyholders' dividends payable in following calendar year—estimated amounts:		
	7.1 Apportioned for payment to ...., 19 .... $		
	7.2 Not yet apportioned		
8.	Amount provisionally held for deferred dividend policies not included in Item 7		
9.	Premiums and annuity considerations received in advance less $ .... discount; including $ .... accident and health premiums		
10.	Liability for premium deposit funds		
11.	Policy and contract liabilities not included elsewhere:		
	11.1 Surrender values on cancelled policies		
	11.2 Provision for experience rating refunds		
	11.3		
12.	....		
13.	Commissions to agents due or accrued—Life and Annuity $ .... Accident and Health $		
14.	General expenses due or accrued (Exhibit 5, Line 11)		
15.	Taxes, licenses and fees due or accrued (including $ .... U. S. federal income tax) (Exhibit 6, Line 8)		
16.	"Cost of collection" on premiums and annuity considerations deferred and uncollected in excess of total loading thereon		
17.	Unearned investment income (Exhibit 3, Col. 2)		
18.	Amounts withheld or retained by company as agent or trustee		
19.	Amounts held for agents' account (including $ .... agents' credit balances)		
20.	Remittances and items not allocated		
21.	Net adjustment in assets and liabilities due to foreign exchange rates		
22.	Liability for benefits for employees and agents if not included above		
23.	Borrowed money $ .... and interest thereon $		
24.	Dividends to stockholders declared and unpaid		
25.	Miscellaneous liabilities (give items and amounts)		
	25.1 Mandatory securities valuation reserve		
	25.2		
	25.3		
	25.4		
	25.5		
	25.6		
	25.7		
	25.8		
	25.9		
25A.	Separate Account Business (see Separate Account Statement)		
26.	TOTAL LIABILITIES (Except Capital)		
27.	Special surplus funds:		
	27.1 .... $		
	27.2		
	27.3 .... $		
28.	Capital paid-up		
29.	Unassigned surplus		
30.	Total of Items 27 to 29		
31.	TOTAL		

4

ANNUAL STATEMENT FOR THE YEAR 1962

Form 1

Except for Items 41A, 42, 48A and 51, the figures on this page do not include Separate Account items, if any.

OF THE .... (Write or stamp name of Company) .... COMPANY

SUMMARY OF OPERATIONS
(ACCRUAL BASIS)

		DOLLARS	CENTS
1.	Premiums and annuity considerations (Exhibit 1, Part 1)		
	1.1 Life		
	1.2 Accident and health		
2.	Considerations for supplementary contracts with life contingencies		
3.	Considerations for supplementary contracts without life contingencies and dividend accumulations		
4.	Net investment income (Exhibit 2)		
5.	....		
6.	....		
7.	TOTAL		
	DEDUCT:		
8.	Death benefits		
9.	Matured endowments		
10.	Annuity benefits		
11.	Disability benefits		
12.	Surrender benefits		
12A.	Group conversions		
13.	Benefits under accident and health policies		
14.	Interest on policy or contract funds		
15.	Payments on supplementary contracts with life contingencies		
16.	Payments on supplementary contracts without life contingencies and of dividend accumulations		
17.	Increase in aggregate reserve for policies and contracts with life contingencies		
18.	Increase in reserve for supplementary contracts without life contingencies and for dividend accumulations		
19.	....		
20.	Subtotal (Items 8 to 19)		
21.	Commissions on premiums and annuity considerations		
22.	....		
23.	General insurance expenses (Exhibit 5, Cols. 1 and 2, Line 13)		
24.	Insurance taxes, licenses and fees (Exhibit 6, Cols. 1 and 2, Line 10)		
25.	Increase in loading on and cost of collection in excess of loading on deferred and uncollected premiums		
26.	....		
27.	Total (Items 20 to 26)		
28.	Net gain from operations before dividends to policyholders and excluding capital gains and losses (Item 7, minus Item 27)		
29.	Dividends to life policyholders (Exhibit 7)		
30.	Dividends on accident and health policies (Exhibit 7)		
31.	Increase in amount provisionally held for deferred dividend policies		
32.	TOTAL (Items 29 to 31)		
33.	NET GAIN FROM OPERATIONS AFTER DIVIDENDS TO POLICYHOLDERS AND EXCLUDING CAPITAL GAINS AND LOSSES (Item 28 minus Item 32)		

SURPLUS ACCOUNT

		DOLLARS	CENTS
34.	Special surplus funds December 31, previous year		
35.	Unassigned surplus December 31, previous year		
36.	....		
36A.	....		
36B.	....		
37.	Net gain (from Item 33)		
38.	Net capital gains (Exhibit 4, Col. 6)		
39.	Surplus paid in		
40.	Net gain from non-admitted and related items (Exhibit 14, Col. 3, Line 40)		
41.	Decrease in mandatory securities valuation reserve		
41A.	Increase in surplus of Separate Account Business (see Separate Account Statement)		
42.	TOTAL		

		DOLLARS	CENTS
43.	Dividends to stockholders		
44.	....		
44A.	....		
44B.	....		
45.	Net capital losses (Exhibit 4, Col. 6)		
46.	Increase in reserve on account of change in valuation basis		
47.	Net loss from non-admitted and related items (Exhibit 14, Col. 3, Line 40)		
48.	Increase in mandatory securities valuation reserve		
48A.	Decrease in surplus of Separate Account Business (see Separate Account Statement)		
49.	Special surplus funds December 31, current year (Item 27, Page 3)		
50.	Unassigned surplus December 31, current year (Item 29, Page 3)		
51.	TOTAL		

Form 1
The figures on this page do not include Separate Account items, if any.

ANNUAL STATEMENT FOR THE YEAR 1962

9

OF THE .... COMPANY
(Write or stamp name of Company)

EXHIBIT 5—GENERAL EXPENSES

	INSURANCE		INVESTMENT	TOTAL
	Life (1)	Accident and Health (2)	(3)	(4)
1. Rent				
2. Salaries and wages				
3.11 *Contributions for benefit plans for employees				
3.12 *Contributions for benefit plans for agents				
3.21 Payments to employees under non-funded benefit programs				
3.22 Payments to agents under non-funded benefit programs				
3.31 Other employee welfare				
3.32 Other agent welfare				
3.4				
4.1 Legal fees and expenses				
4.2 Medical examination fees				
4.3 Inspection report fees				
4.4 Fees of public accountants and consulting actuaries				
4.5 Expense of investigation and settlement of policy claims				
4.6				
5.1 Traveling expenses				
5.2 Advertising				
5.3 Postage, express, telegraph and telephone				
5.4 Printing and stationery				
5.5 Cost or depreciation of furniture and equipment				
5.6 Rental of equipment				
5.7				
6.1 Books and periodicals				
6.2 Bureau and association dues				
6.3 Insurance, except on real estate				
6.4 Miscellaneous losses				
6.5 Collection and bank service charges				
6.6 Sundry general expenses				
6.7 Group service and administration fees				
6.8				
7.1 Agency expense allowance				
7.2 Agents' balances charged off (less $ recovered)				
7.3 Agency conferences other than local meetings				
8.1				
8.2				
9.1 Real estate expenses				
9.2 Investment expenses not included elsewhere				
9.3				
10. General Expenses Paid				(To Line 27, Exhibit 12)
11. General expenses unpaid December 31, current year				
12. General expenses unpaid December 31, previous year				
13. General expenses incurred during year (10+11−12)	(To Item 20, Page 4)		(To Line 4, Exhibit 2)	

A. Compensation to agents on a plan other than commissions, included in Col. (1): First year $, Renewal $

B. Agency supervision, except Home Office, included in Col. (1): Line 2 $, Line 5.1 $, Line $

C. Branch office expenses other than those in A and B included in Col. (1): Line 1 $, Line 2 $, All other lines $

*These items include $ .... on account of prior service.

EXHIBIT 6—TAXES, LICENSES AND FEES

	INSURANCE		INVESTMENT	TOTAL
	Life (1)	Accident and Health (2)	(3)	(4)
1. Real estate taxes				
2. State insurance department licenses and fees				
3. State taxes on premiums				
4. Other state taxes, incl. $ Social Security				
5.1 U. S. federal income tax				
5.2 Other U.S. federal taxes, incl. $ Social Security				
6. All other taxes				
7. Taxes, Licenses and Fees Paid				(To Line 28, Exhibit 12)
8. Taxes, licenses and fees unpaid December 31, current year				
9. Taxes, licenses and fees unpaid December 31, previous year				
10. Taxes, licenses and fees incurred during year (7+8−9)	(To Item 24, Page 4)		(To Line 5, Exhibit 2)	

NOTE: Canadian and other foreign taxes are included appropriately in Lines 1, 2, 3, 4 and 6.

EXHIBIT 7—DIVIDENDS TO POLICYHOLDERS

	Life	Accident and Health
1. Applied to pay renewal premiums		
2. Applied to shorten the endowment or premium-paying period		
3. Applied to provide paid-up additions		
4. Applied to provide paid-up annuities		
5. Total Lines 1-4		
6. Paid in cash		
7. Left on deposit with the company		
8.		
9. Total Lines 5-8		
10. Amount due and unpaid (Item 6, Page 3)		
11. Provision for annual dividend policies, including $ terminal dividends (Item 7, Page 3, in part)		
12. Provision for deferred dividend policies (Item 7, Page 3, in part)		
13. Total Lines 10-12		
14. Line 13 of previous year		
15. Total Dividends to Policyholders (Lines 9+13−14)	(To Item 30, Page 4)	(To Item 30, Page 4)

Form 1
Except for Items 14A, 15, 37A and 38-41, the figures on this page do not include Separate Account items, if any.

ANNUAL STATEMENT FOR THE YEAR 1962 13

OF THE .... COMPANY

(Write or stamp name of Company)

EXHIBIT 12—RECONCILIATION OF LEDGER ASSETS

		DOLLARS	CENTS
	INCREASES IN LEDGER ASSETS		
1.	Premiums on life policies and annuity considerations (see Exhibit 1, Part 1)		
2.	Accident and health cash premiums, including $ policy, membership and other fees		
3.	Consideration for supplementary contracts with life contingencies		
4.	Consideration for supplementary contracts without life contingencies including $ disability		
5.	Dividends left with the Company to accumulate at interest		
6.	Interest, dividends and real estate income (Exhibit 3, Column 1)		
7.	Increase of paid-up capital during the year		
8.	From other sources (give items and amounts):		
	8.1		
	8.2		
	8.3		
9.	Borrowed money gross $, less amount repaid $		
10.			
11.			
12.			
13.	From sale or maturity of ledger assets (Exhibit 4, Column 2)		
14.	By adjustment in book value of ledger assets (Exhibit 4, Column 1)		
14A.	Separate Account Business (see Separate Account Statement)		
15.	TOTAL INCREASES IN LEDGER ASSETS		
	DECREASES IN LEDGER ASSETS		
16.	Policy and contract claims:		
	16.1 Life (see Exhibit 11, Part 2)		
	16.2 Accident and health		
17.	For annuities with life contingencies, excluding payments on supplementary contracts (including cash refund payments)		
18.	Premium notes and liens voided by lapse, less $ restorations		
19.	Surrender values		
19A.	Group conversions		
19B.	Interest on policy or contract funds		
20.	Dividends to policyholders:		
	20.1 Life insurance and annuities (Exhibit 7)		
	20.2 Accident and health (Exhibit 7)		
21.	TOTAL PAID POLICYHOLDERS		
22.	Paid for claims on supplementary contracts:		
	22.1 With life contingencies		
	22.2 Without life contingencies		
23.	Dividends and interest thereon held on deposit disbursed during the year		
24.			
25.			
26.	Commissions to agents (less commissions on reinsurance):		
	26.1 Life insurance and annuities (including $ commuted commissions)		
	26.2 Accident and health (including $ commuted commissions)		
	26.3 Policy, membership and other fees retained by agents		
27.	General expenses (Exhibit 5, Line 10)		
28.	Taxes, licenses and fees (Exhibit 6, Line 7)		
29.	Decrease of paid-up capital during the year		
30.	Paid stockholders for dividends (cash $, stock $)		
31.	Borrowed money repaid gross $ less amount borrowed $		
32.	Interest on borrowed money		
33.			
34.			
35.			
36.	From sale or maturity of ledger assets (Exhibit 4, Column 4)		
37.	By adjustment in book value of ledger assets (Exhibit 4, Column 3 and Exhibit 2, Line 4)		
37A.	Separate Account Business (see Separate Account Statement)		
38.	TOTAL DECREASES IN LEDGER ASSETS		
	RECONCILIATION BETWEEN YEARS		
39.	Amount of ledger assets December 31st of previous year		
40.	Increase (+) or decrease (−) in ledger assets during the year (Line 15 minus Line 38)		
41.	TOTAL — LEDGER ASSETS DECEMBER 31st OF CURRENT YEAR		

Except for items 25A and 26, the figures on this page do not include Separate Account items, if any.

OF THE .... COMPANY
(Write or stamp name of Company)

EXHIBIT 13—ASSETS

	Ledger Assets (1)	Non-Ledger Assets (2)	Assets Not Admitted (3)	Net Admitted Assets (4)
1. Bonds				
2. Stocks				
3. Mortgage loans on real estate:				
3.1 First liens				
3.2 Other than first liens				
4. Real estate (less $ encumbrances):				
4.1 Properties occupied by the company				
4.2 Properties acquired in satisfaction of debt				
4.3 Investment real estate				
5. Policy loans				
6. Premium notes (including $ for first year premiums)				
7. Collateral loans				
8. Cash and bank deposits:				
8.1 Cash in company's office				
8.2 Deposits in banks and trust companies (Schedule E)				
9.				
10.				
11. Amounts recoverable from reinsurers				
12. Other assets (give items and amounts):				
12.1 Agents' balances (debit $ credit $)				-0-
12.2 Bills receivable				-0-
12.3 Furniture and equipment				
12.4 Cash advanced to or in hands of officers or agents				-0-
12.5 Loans on personal security, endorsed or not				-0-
12.6				
13.				
14.				
15.				
16.				
17. Life insurance premiums and annuity considerations deferred and uncollected on in force Dec. 31st of current year (less reinsurance premiums):				
17.1 Industrial uncollected (excluding $ loading)				
17.2 Ordinary deferred and uncollected—New business (excluding $ loading)				
17.3 Ordinary deferred and uncollected—Renewal (excluding $ loading)				
17.4 Group life deferred and uncollected (excluding $ loading)				
17.5 Group annuity uncollected (excluding $ loading)				
17.6 Total (to Col. 2)				
18. Accident and health premiums due and unpaid				
19. Interest and real estate income due and accrued:				
19.1 Interest due and accrued				
19.2 Real estate income due and accrued				
19.3				
20. Net adjustment in assets and liabilities due to foreign exchange rates				
21.				
22.				
23.				
24.				
25.				
25A. Separate Account Business (see Separate Account Statement)	X X X X X	X X X X X	X X X X X	
26. Totals				

EXHIBIT 14—ANALYSIS OF NON-ADMITTED ASSETS AND RELATED ITEMS

(Excluding Investment Adjustments Not Listed)

	End of Previous Year (1)	End of Current Year (2)	Changes for Year Increase (−) or Decrease (+) (3)
27. Company's stock owned			X X X X X
28. Loans on company's stock			
29. Supplies, stationery, printed matter			
30. Furniture and equipment			
31. Commuted commissions			X X X X X
32. Agents' balances (net)			
33. Cash advanced to or in the hands of officers or agents			
34. Loans on personal security endorsed or not			
35. Bills receivable			
36. Premium notes, etc., in excess of net value and other policy liabilities on individual policies			X X X X X
37. Accident and health premiums due and unpaid, effective prior to October 1			
38. Other assets not admitted (itemize)			
38.1			
38.2			
38.3			
39. Agents' credit balances (Page 3, Item 19 inside)			
40. Total Change (Col. 3)*	X X X X X	X X X X X	

*(Carry to Item 40, Page 4 if (+), or to Item 47, Page 4 if (−))

ROOM USE ONLY

0131-69

MICHIGAN STATE UNIVERSITY LIBRARIES
3 1293 03178 3156