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PROFESSIONAL RELATIONSHIPS WITH CERTIFIED PUBLIC ACCOUNTANTS

A review of the critical relationships with our CPA counterparts on such topics as GAAP, Pension Audit Guide, and the accounting practices for mutual life companies.

CHAIRMAN MORTON D. MILLER: During the past decade, the actuarial and accounting professions have been drawn increasingly together. A first major step was taken in the mid-1960's with the formulation of APB Opinion No. 8 on Pensions. That was followed by the Property and Casualty Company Audit Guide. More recently, additional impetus has been put toward bringing our two professions together in terms of the Stock Life Guide and the fact that companies are using outside audit firms to a greater degree than they had in the past. Finally, we have ERISA, the new Pension Plan Act, which is still in the process of being understood and implemented.

The importance of the role that our two professions play in today's society can hardly be overstated. It is, therefore, ever more necessary that we work closely together, one with the other, and try to establish a comfortable relationship with open communications so that we can serve the public in a satisfactory way in performing our assigned tasks.

As a consequence, it is even more important that we now have a fine vehicle for communication with the accounting profession, and they with us. A couple of years ago we established a continuing liaison relationship with the AICPA in the form of two parallel committees, namely the AICPA Committee on Relations with Actuaries, and the American Academy of Actuaries Committee on Relations with Accountants.

One of the first things that the committees did was to establish for themselves the following statement of purposes:

"The purpose of these parallel committees is to provide a continuing facility for high level communication between the two professions, thus affording opportunity and a constantly available medium for close and sound relationships. It is expected that the committees will meet at regular intervals as well as whenever a specific need arises to discuss matters of a policy nature involving the two professions. Task forces of each profession will operate as needed to work on detailed matters for particular questions and situations in close cooperation with the two committees. It is the objective in establishing the committees to enable the professions to understand each other's work and needs more clearly and to initiate a mutual dialogue at an early stage of any situation involving both disciplines. This should ameliorate any area of possible conflict and misunderstanding. It will also assure a ready means for any one in either profession to obtain an answer to a question he may have which involves the expertise of the other profession."

I can assure you, since I've been heavily involved in this from the beginning, that these committees are accomplishing their purpose.

Today, we hope to review the critical relationships between our professions through an unstructured discussion. We plan to divide our time between financial reporting for companies and pension plan matters. We will start by asking Don Trautlein to tell us something about the current structure of the accounting profession.

MR. DONALD H. TRAUTLEIN:* Like doctors and lawyers, accountants are licensed by the various states. However, there is a uniform CPA examination which is prepared and given by the profession, the American Institute of CPAs. This examination parallels that for associateship in the Society as it is given in four parts and takes about 20 hours over three days.

The qualifications for the independent auditor can be characterized by the three E's, that is, education, experience and the examination. Almost all states now require that all independent auditors have a college degree with a training background in accounting and auditing. Additionally, most states have an experience requirement, e.g. three years in New York, before you can take the final parts of the examination and, as I've indicated, the examination is quite comprehensive. Having completed these three E's, you are licensed by the state as a CPA. Currently there are somewhat in excess of 100,000 members of the American Institute of CPA's.

The last several years have seen quite a change in the extent to which the public is expecting a very high level performance and an increasing involvement by the auditor. Just about two years ago, the responsibility for defining accounting principles passed from the Institute to a private group, the Financial Accounting Standards Board, as a result of a study undertaken by the Wheat Commission. So now accounting principles are being defined primarily by three groups; mainly by the FASB, but with a very active involvement by the Securities and Exchange Commission, and, of course, by the Institute also.

In addition, another independent commission under the former SEC chairman, Manny Cohen, is currently taking a look at our responsibilities as auditors; and at this point they have identified a list of 16 things we ought to be considering.

MR. RICHARD S. ROBERTSON: The accounting profession appears to be like ours in that during the early years of an accountant's career he passes an examination which qualifies him to practice. Yet the examination is basic, like ours, and so it can't cover the entire field. Furthermore, there's a real need for the accountant, like the actuary, to keep up on continually changing developments. What provisions are there in the profession for doing that?

MR. TRAUTLEIN: This is being done in a variety of ways. For example, it's being done by the individual firms, as almost all of the larger firms have extensive training programs. It's also being done by the Institute. For instance, after the Stock Life Insurance Audit Guide was adopted, the Institute prepared a comprehensive course that was made available around the country. Continuing education is currently on everybody's mind. As a matter of fact, it's one of the 16 items on the Cohen Commission's list of things that should be looked at. Although it is going forward on many fronts, both within the individual firms and within the profession, I think we are just getting started on it and that there will be a lot more going on in the next few years.

CHAIRMAN MILLER: Don, would you want to comment on the fact that there are other groups that impinge on the activities of both of our professions in a very significant way?

MR. TRAUTLEIN: Yes, in addition to the SEC and the Financial Accounting Standards Board, which I have already mentioned, there is another group that isn't too widely known, called the Cost Accounting Standards Board. They deal

*Mr. Trautlein, not a member of the Society, is a partner in the firm of Price Waterhouse & Company and is a CPA.

with government contractors and they've been setting rules and procedures for accounting practices that defense contractors must follow. Of course, both accountants and actuaries are impacted from the life insurance side by the NAIC. Finally, there is an International Accounting Standards group that is looking into accounting principles. Thus, there is a lot of activity going on by a great number of people. That is why it's awfully important that we keep communicating with each other so we aren't working at cross-purposes, and so we get the job done.

CHAIRMAN MILLER: Now let's turn to the financial reporting for insurance companies.

Dick, you're on the Academy Committee, why don't you give us some of the background and other comments you might want to make.

MR. ROBERTSON: Several years ago, when we first had the need or requirement that the Lincoln National file audited statements, there was a great deal of hesitancy on our part. We had gotten along for years without being concerned with accountants and we didn't really have an appreciation for the problems they have to face or for what their responsibilities are. It took considerable discussion to develop a good working relationship. This relationship is now excellent in our case, and I think that this is also the case for most life insurance companies that are now filing audited statements.

Although I can't speak directly for the accounting profession, I think that the accountants were not getting all the input from the actuarial profession that they needed for the first exposure draft of the Audit Guide, and they probably didn't recognize that that need existed. Fortunately, we were able to establish the type of communication that was necessary, and the current Audit Guide does a very fine job of discussing what the particular role of the actuary is as opposed to the role of the accountant.

The actuary is discussed in several sections of this Audit Guide. There is a section entitled "Utilization of Actuaries" that, in essence, says that the accountant should recognize that he is not qualified to pass on the actuarial matters in the statement, and that he is going to have to use, work with, and seek the advice of actuaries. There's another section entitled "Reliance on Actuaries" which points out that the accountant cannot absolve himself of responsibility for the actuarial aspects of the statement since he is the one who is the auditor. Also, there is a section that discusses actuarial assumptions and points out that, although the actuary is the person that is qualified to determine what assumptions are appropriate, the accountant should satisfy himself that the actuary is applying standards that are consistent with Generally Accepted Accounting Principles in selecting the assumptions.

The Audit Guide makes reference to the Academy of Actuaries' Guide to Professional Conduct which describes the disciplines under which the actuary operates. The Guide also discusses the problem that the actuarial profession does not yet have a formal procedure for developing standards for the assumptions that are to be used in general purpose financial statements.

The actuarial profession, on its behalf, has also investigated the relationship of the actuary to the auditor. The Professional Conduct Committees of both the Academy and the Society have issued opinions specifically discussing how the Guide to Professional Conduct is to be interpreted when applied to financial reporting for stock life insurance companies. Opinions A-6 of the Academy and S-6 of the Society discuss this in considerable detail.

The Academy of Actuaries' Committee on Financial Reporting Principles has also been considering various aspects of this question. Recommendation 2 deals with the need for a written plan of coordination as to what the role of the actuary is going to be in a given situation. Interpretation 2A gets more specific, and refers to specific sections of the Audit Guide. Recommendation 3 talks about the need for actuarial reports and statements of actuarial opinion, while Interpretation 3A gives certain examples.

Other recommendations and interpretations of the Committee discuss the problems of assumptions and procedures. All of these recommendations and interpretations have been exposed to a wide body of people, including several members of the accounting profession, and their input has been very helpful in improving and clarifying them.

In addition to these committees, there is a great deal of work being done in other committees and other parts of the profession. For instance, the Joint Committee on Theory of Risk, chaired by John Wooddy, is doing a great deal of theoretical work trying to evaluate the effect of different provisions for adverse deviation in actuarial assumptions. Also, many individual actuaries have published papers that approach these subjects from different points of view. Of course, individual actuaries are continually concerned with the problems of relations with auditors and accountants in their own company activities and their own consulting firm activities.

CHAIRMAN MILLER: Would you just mention how the Academy's Committee is now structured? I like to keep before people that it is not only a Life Insurance Committee, but that it is concerned with Property and Casualty matters as well.

MR. ROBERTSON: The Committee on Financial Reporting Principles started out primarily as a life insurance committee, because that's where the real crisis was at the time. Although we recognized the fact that what we were doing had casualty overtones, and although there were casualty actuaries on the committee, as developments proceeded it became quite clear that there was a need for a comparable committee composed primarily of casualty actuaries.

So, about a year or eighteen months ago, the Academy's Committee on Financial Reporting Principles was reorganized as a parent committee concerned with financial reporting in general, and, at present, two subcommittees, one concerned with life insurance accounting and one concerned with general insurance accounting. There is also a steering group which coordinates activities of these two subcommittees.

One current project of the general insurance accounting subcommittee is to update and modify the Audit Guide for the property and casualty industry.

CHAIRMAN MILLER: I want to add emphasis to Dick's statement that the work of the Financial Reporting Principles Committee is reviewed by the accountants.

We have a communications system that sends our accounting friends practically everything that's done in these committees and they do react. At the same time, they send to us the things that they're doing and we react. There's really a strong and continuous day-by-day communication between the two groups now whereby each gets the input of the other concerning nearly everything that goes on that affects both professions.

MR. BARRY L. BLAZER: During the last ten minutes, we have discussed certain aspects of the actuarial and accounting professions and their current positions vis-a-vis one another, and we have established the fact that there are many effective channels of communications between the two groups. But when Dick described the history of the work of the Academy's Financial Reporting Committee, he didn't really address himself to this question: What was the mood in the actuarial profession four or five years ago? At that time, the accounting profession was thought to be making substantial inroads into the activities of the actuary, and many of us were concerned that the CPA firms might start doing the work that actuaries were doing. Because this concern came about in large part because of the reference to reliance in the auditor's report, perhaps Don could expand a little on the development of the reliance concept. Parenthetically, let me just mention, however, that there has been a substantial change in the mood of people in the life insurance area, in both the Society and the Academy.

MR. TRAUTLEIN: In those early years, I think accountants realized that ultimately we were going to have to talk with actuaries and find out something about what they did. We did not want to try to be actuaries; but since actuarial calculations were going to be very significant in the financial statements, we were going to have to know something about them. There is always a matter of timing. But we all worry about things that we don't know anything about and that's why it's important in these developing areas that we start talking with each other at an early stage even if we aren't so sure what directions we are taking.

This reliance matter has been discussed for years, and it's going to be the subject of a proposed statement on auditing standards of the Institute entitled "Using the Work of Non-Accounting Specialists". I suspect no one likes to be grouped with a group of other professionals even though they are people like lawyers or engineers or whatever. But in an accountant's examination of a set of financial statements, and especially in those of large companies, we use the work of many professions. We try to get guidance from them so that we can fulfill our role, which is to express an opinion on the overall financial statements. These responsibilities are required by law. They are what the public wants, and we can't get away from them. In order to fulfill them, we have to know something about the work of other people and get proper reporting from them. Now, there is no way that we can fragment the responsibility for expressing our opinion as to the fair presentation of those statements. By law that is the auditor's responsibility. As you know, the only thing in the financial statements that really is ours is the opinion; the financial statements are the company's.

One other point is that all the work that we do is a second look. As independent auditors, we don't do any original work, and we are not trying to take any first looks. Actuaries will take the first look, as will geologists, lawyers, accountants in the company, etc. We come along and see whether, on a second look, the financial statements present fairly the financial position and the results of operations.

MR. EDWARD H. COLTON: When you choose a non-accounting specialist from a class of actuaries, is there a definition of actuary emerging that might be uniform in the accounting profession?

MR. TRAUTLEIN: In 98 or 99% of the cases we are not going to choose a non-accounting specialist, whether it's an actuary, lawyer, or whatever. He is already going to be there or the company is going to have chosen him. I think that it's a common misconception that we are going to bring somebody else in. There are very few cases where the accountant feels that he has to engage a non-accounting specialist. There can be a particular case in which he really feels that he has to go out and get a separate opinion because it is so important. But, for the most part, he won't.

As for a definition of "actuary", we look to the actuarial profession. As we indicated in the Audit Guide for Stock Life Insurance Companies, membership in the Academy is considered on the surface to indicate qualification. We are not going to try to set those standards.

MR. COLTON: Suppose your work papers indicate that you conferred with an actuary. Is this going to be a member of the Academy? Also, if the particular individual you speak with happens to be a member of the Society of Actuaries, but not the Academy, is he therefore not an actuary? Is there any pattern emerging in that area?

MR. TRAUTLEIN: No, here again we would look to the Academy or the Society, i.e., to the actuarial profession, for their guidance. I would not want to, and I am sure no other accountant would want to, try to decide what makes a qualified actuary. We are going to look to you, or to whatever other specialists we are using, to decide what makes somebody qualified. Of course, some actuaries, because of their associations, will be prima facie qualified. The Labor Department is going to have to deal with this question also in connection with ERISA.

MR. COLTON: The reason for my question is that I have seen in print an accounting firm make reference to what qualifications an actuary must have.

MR. TRAUTLEIN: Yes, we know. That has been discussed in our committee and, Mort, you might like to comment on it.

By the way, this is not an opinion of the profession. Any accounting firm or any actuarial firm can make their own standards which are different, and I would think greater, than those of the profession. As long as they are applying the standards of the profession together with their own, there is nothing the profession can do about it.

CHAIRMAN MILLER: We've had long discussions of this very situation. There was one major accounting firm that put together material which placed emphasis on the professional status of the actuary, either as a member of the Society or of the Academy. But some of the language they used didn't please us too much. This led to several discussions with them, as a result of which we expect that in the future they will modify those parts of their material that we weren't pleased with. Again, this is a product of our open communications channels, and we think we have worked this one out to our satisfaction.

MR. LOUIS WEINSTEIN: In several accounting firms, there is a policy that, when feasible, an actuary will participate in the second look, particularly an actuary who has not been actively involved in the first look. I am concerned that Mr. Trautlein indicated that an actuary might not be needed because the accounting firm would have confidence in either the qualifications or the skill of the actuary who was involved in the doing phase. That would imply that, when a non-accounting specialist is called in to assist in the second look, this is somehow an insult to the actuary who was involved in the first look. This is not the case.

MR. TRAUTLEIN: I did not mean to imply that the independent look or second look might not involve another actuary. It depends on a lot of things. For instance, how much does the accountant himself know? How many insurance examinations has he been involved in? What does he know about actuarial science as a layman? What does he know about the people there? Has he had people involved in the past? If he can satisfy himself, he may decide that he doesn't need to get another actuary. We, as a firm, do not have actuaries, but we have engaged outside actuaries to assist us in that second look. I didn't mean to imply that the independent look would be made without the assistance of an actuary.

MR. HERBERT J. STARK: I've had a good deal of experience with CPA's, both my own and as an investor in various corporations. It seems to me that there is a fundamental difference between the role of the actuary and the role of the

CPA. The actuary is trained, by definition, to follow financial probabilities through time. The CPA is not. He is concerned with the here-and-now and occasionally the ancient history. Thus, I do not feel that the CPA is competent to question the judgment of the actuary in matters pertaining to the progress through time of financial matters involving contingencies. Rather, it seems to me that there are phases of corporate affairs now considered solely the province of the CPA which require the special knowledge of the actuary. Let me refer to just two of these.

One is the case of the corporation involved in a great many lines of business - the so-called conglomerate. We are shocked as investors, with considerable regularity, by learning of unexpected major charges for the discontinuance of this or that unprofitable line of business. It seems to me that reserves on an actuarial basis should be set up in advance for possible discontinuance of some of the lines of business of a multibusiness corporation.

Second, there is the matter of inventories, particularly since the adoption generally of LIFO. With regard to inventories, say, of copper, you can tell the lesser of cost and market pretty readily. With respect to inventories, say, of silicon transistor chips, there is another factor that comes in, and that is the eventual obsolescence and replacement of the value of the inventory by something new that has come out since. It seems to me that consideration should be given to a reserve on an actuarial basis against inventory market values of manufactured goods and goods-in-process, to take care of the probable obsolescence of some of them.

MR. TRAUTLEIN: I would agree with you that actuaries have been concerned much more than accountants with measurement problems of a long-term nature. But I wouldn't want to leave the impression that the financial statements don't reflect other measurements of a long-term nature. For instance, the whole area of depreciation for a large manufacturing company is a long-term measurement problem. There are also other liabilities besides actuarial liabilities that present long-term measurement problems. So accountants are aware of these problems. I do agree with you, however, that probably none of these long-term measurement problems are as large or as long term as the pension and life insurance liabilities.

MR. BLAZER: I think that members of the accounting profession realized several years ago that they weren't qualified to make actuarial judgments. Nevertheless, the profession was faced with the responsibility of offering opinions on the fairness of the presentation of financial statements. As a result, accountants had to do something to increase their understanding of the actuary's work. A number of accounting firms already had actuaries working within their organizational structures. Arthur Young, having no such input available, decided that it would be advantageous to hire actuarial personnel. The idea on the part of these firms was to seek some protection from financial lawsuits. Certainly, no one would argue about the CPA's inability to interpret actuarial formulas or certain actuarial assumptions.

CHAIRMAN MILLER: Don, would you like to comment on how the accountants view the first year or two's experience with respect to the use of the Stock Guide?

MR. TRAUTLEIN: Well, I think the experience of the people I've talked with and my own experiences have been generally good. As far as I can tell, people have tried to use realistic assumptions, people have worked together well, and people have seen that accountants have no illusions that they should try to act as actuaries. We are merely trying to understand something about the actuary's role in order to properly fulfill our role.

Now, I can understand some of the actuarial assumptions. I know, for instance, that, if someone comes along and tells me that he is assuming a 10% interest rate, then I should stop and ask him why he used such a high rate. I am not saying that maybe that isn't the proper rate. I just want to understand how it was arrived at. Similarly, if a lawyer sets up a five million dollar reserve on the books for this, that, or the other suit, I should ask him how he arrived at the five million dollar figure. We are not going to come along and say that we don't think it should be five, it ought to be four or six. Instead, we are trying to sit down and perform the role that society looks to us to perform. I feel that it is the same thing with the actuarial liabilities. We are not trying to second-guess the actuary. We are just trying to understand the judgments. We are not trying to make them or change them. Understanding is the word.

MR. ROBERT G. ESPIE: I think there is too much unnecessary fear of this so-called interference on the part of the CPA's with the actuaries. What comes to mind is an analogy. The actuary of a company may work for a president or a board of directors who are not actuaries. They may still look over his shoulder and question the mortality and interest assumptions, ask him for his reasoning, and satisfy themselves that what he is doing is reasonable. I don't think the CPA's are really doing any more than those executives do in that case, and that is a situation we have learned to live with.

CHAIRMAN MILLER: I believe we should turn to the pension side of our deliberations now. Ed, would you like to introduce the subject?

MR. EDWARD H. FRIEND: I think that the best way to begin is to go back to something that Barry said a little while ago. He referred to the mood which prevailed several years ago when insurance companies began to face the serious problem of developing relationships with accountants. At that time, the mood was a difficult one. Over a period of four or five years the professions in this area have learned to work together well, and there seems to be a real joining of hands.

I would say that the mood in the pension area is like the mood that was present some five years ago in connection with the stock life insurance company problems. The mood is one of some concern, a "feeling of intrusiveness." Now, the validity of this mood is not necessarily something that one can judge at this stage, but there are a number of questions that arise that give credence to this kind of concern.

The question of reliance enters very importantly in the pension area. In particular, the new Pension Reform Act specifically states that, in offering his opinion, the accountant may rely on the correctness of any actuarial matter certified to by an enrolled actuary if he states his reliance. The question arises as to why the accountant doesn't exercise this reliance. As Don has answered, apparently the accounting profession has not yet taken the position that it can rely even on the words in this Act. This is a cause of some concern.

When Don and Barry talk about hiring actuaries to protect their legal responsibility, the actuary turns to this particular kind of wording in the Act. He also wonders why the accountants haven't hired attorneys or geologists, but have only hired actuaries. At yesterday's panel, there were strong questions raised. For instance, do you look at our professional credentials, our reputation, our background, and decide to accept our word on the basis of what you know to be competence? Or are you going to look at what we do?

Finally, there is the question of what appears to be different attitudes by different accounting firms. I think it is safe to say that the Society, and probably because of its size, the actuarial profession, has a set of uniform views on many of these subjects. We differ, yes, but by and large our attitudes and responses to many of these problems are similar. We find fragmentation in the accounting profession, however, particularly among the big eight. Their different viewpoints lead to different practices which impact downward to the smaller accounting firms, many of which have neither the time nor the personnel to study these problems. Instead, they take doctrine, which they have accepted from the larger firms in some cases without understanding their implication and shades of meaning. This may cause problems.

MR. TRAUTLEIN: I'm in complete agreement that we are in a very evolutionary stage here, and there's concern on all of our parts as to how we are going to fill the roles that the Act places on both of us. I would start off by mentioning that the Act was only passed a little more than six months ago, and so the first real reporting problems we are going to have are almost 18 months down the road. So we do have some time to work together and try to sort out our roles and responsibilities. Of course, a large part in this is going to be played by the Labor Department. Perhaps we should get together, as accountants and actuaries, and join in talking to the Labor Department to try to get this sorted out so that we both can live with it.

No one really knows the form of financial statements that the Labor Department is going to require. There are general terms, but it could be that what the accountants are asked to report on won't even include actuarial liabilities, and so the problem could even go away. We just don't know. It's something that is very much in an evolutionary stage. If we are all of good will and try to understand each other's roles, I think we'll work it out to our mutual satisfaction.

MR. BLAZER: I don't think it's fair to characterize the actuarial profession as totally unified on this point and the accounting profession as totally at odds with one another. I'm not an expert in this field, but I don't believe the actuarial profession has been able to reach complete agreement on the actuarial principles and assumptions used in developing pension cost estimates, although attempts to reach such agreement have been made for some time. Furthermore, it's inaccurate to say that members of the accounting profession are not working together or that the larger firms, for their own benefit, are forcing certain accounting principles on the smaller firms. As Don has already noted, neither the accounting nor the actuarial profession knows exactly where it's going with respect to the reporting aspects of ERISA. I understand the concerns expressed by some actuaries that the auditors are broadening their role at the expense of the actuary. But the recent history of the relationships between life actuaries and CPA's would indicate that this is not going to happen. I work for an accounting firm, and some may think that I'm biased. But, in my present capacity, I've been quick to identify the things that I believe are wrong with the Audit Guide, and I've made my opinions known publicly on these issues. I am not necessarily taking a position in support of what the accounting profession will eventually decide to do. But, on the basis of our experience in the life insurance area, we can anticipate a likelihood that things will work out just as well -- perhaps even better -- in the employee benefits area.

CHAIRMAN MILLER: In terms of unification of viewpoint and process, it seems to me that we, as actuaries, for whatever reasons, are coming from way back. The accountants have a long-established pattern of operation and principles and we don't. It is very true that, through the Society originally, and now through the Academy, there were efforts that go back 15 years or so to try to rationalize actuarial work as it applies in the pension area to a somewhat greater extent.

The biggest stumbling block was that the members wouldn't agree. I think that time is long since past. The actuaries are going to have to come to some larger degree of consensus as to what accepted actuarial principles are going to mean in the pension field, and I would hope that the more recent efforts through the Academy will begin to produce a body of doctrine and scientific input that will go a long way toward rationalizing this particular area.

MR. DAVID LANGER: Barry, you mentioned that your role at Arthur Young is to help protect Arthur Young in its legal responsibilities. Could you give some examples which may have arisen to date in which you have performed this particular function? How might it arise and what might you be protecting, or looking for, in discharging your responsibility?

MR. BLAZER: Much of the work I have done over the last 18 months has been related to the auditing of life insurance companies. As previously noted, audit personnel are not qualified to review the actuarial formulas or techniques used in calculating benefit reserves and deferred acquisition costs. As actuaries, one of the things we are called upon to do is to conduct a review of the technical aspects underlying the calculation of these financial statement entries. In the course of this work, we also review the assumptions that are used in developing these formulas, and we act as liaison between our firm and the inhouse or consulting actuaries.

In practice, situations sometimes arise, or techniques are used, that are not specifically provided for in the Audit Guide. Although I am not a CPA -- nor have I been trained as an auditor -- in such situations I can help to determine the numbers that would have resulted had procedures or formulas been used consistent with those published in the Guide. While I am not the one who determines whether the difference is "material" in an auditing sense, on the basis of the information I supply, the auditor is able to make such a judgment.

MR. RICHARD HUMPHRYS: The dilemmas that are facing the actuaries and accountants are not confined to them. Dilemmas are also facing the regulators. I might illustrate this by a problem that's facing us in Canada. Since the 1920's, our regulatory legislation in Canada has required a certificate by the actuary as to the adequacy of the actuarial reserves.

We also have in our legislation a requirement that the statement be audited and be accompanied by an auditor's certificate. However, the legislation is not at all clear as to what is expected of the auditor. Now, it doesn't seem very logical to take the view that legislation which calls for an actuary's certificate is at the same time calling for certification by another professional of the actuary's work. I think we have to take the view that the legislature was content to rely on the actuary's certificate as respects the actuarial liabilities, and that the auditor's certificate would by implication be acceptable if it said that he was relying on the actuarial liabilities as certified by the actuary.

Some of my accounting friends say that there's no way for them to give us a certificate at all where they don't express a view on such a major liability item. So that poses a dilemma for us and also for the accountants. We can try to escape the dilemma by saying that, so far as the regulators are concerned, they would not regard a qualification by the auditor that he relied on the actuary's certificate as being one that calls for a special explanation or one that would give rise to an action that would ordinarily stem from a qualified certificate.

MR. TRAUTLEIN: Two troublesome areas have existed for the accounting profession that have probably caused most of the case law on the role of the auditor. One relates to related party transactions. The other one is where you have a set of companies that are audited by more than one accountant. When you divide responsibility for something that's a whole, you are immediately increasing the risk of that whole having an undiscovered problem. This is the problem that accountants find even when they divide work among accounting firms; when somewhere along the line you fragment this thing, you increase the likelihood that something may go down the cracks.

Now, we are not certifying the actuarial reserves as the actuary is, or the geological aspects, etc. However, in terms of the overall financial statements, the products of these and other professions have to result in a fair presentation or we cannot express an opinion. It's a difficult concept, but either we're examining the entire financial statements or we're not. From the standpoint of the regulator, or the public, or whoever is relying on those financial statements, his assurance is decreased if the responsibility for the statements is fragmented. In addition, our liability has been significantly increased over the years because people are increasingly looking to us to express an opinion as to the fair presentation of the financial statements on an overall basis, and by law we must do so.

CHAIRMAN MILLER: Isn't Equity Funding a case in point, at least in part?

MR. TRAUTLEIN: Yes, there were various accounting firms involved there. That's a division of work within our own profession where we can know something about what the other fellow ought to do and where we do have the ability to go in and look at his work. But still there are problems.

CHAIRMAN MILLER: I think Dick was saying that he's faced with contradictory regulations, a little different from that situation which you talked to wherein the profession is not otherwise inhibited from doing what you say. I don't know enough about the Canadian situation to know whether this is really a major dilemma. In a sense they can't satisfy the two requirements, one that the actuary do something, and the other that the accountant do something else. It ceases to be a professional matter. Don't you really have to go back to your legislators and ask them what they want done here?

MR. HUMPHRYS: The dilemma that we're facing is what do we go back and tell our legislators? Mr. Trautlein retreated a bit in saying that the law required the accountants to do something. My problem is what should the law require the two groups to do?

MR. TRAUTLEIN: It's also the tenets of our profession that say either you examine the financial statements as a whole or you don't. You can't take something as significant as life insurance reserves in a life insurance company and not examine those, and then express an opinion on the overall financial statements. Your examination would not be complete; it's your examination and somebody else's. As an analogy, if you had three large companies and they were held by a common holding company and three different accounting firms were involved, who does the whole? The answer is we won't stay with that situation.

MR. HUMPHRYS: I recognize your point, but I think the analogy to conglomerates doesn't quite apply in this particular case. It seems to me not unreasonable to look for some verification of the assets, for example, in the financial statement, even though the auditor might accept the actuary's certificate.

MR. TRAUTLEIN: As you know, there are many interrelationships and, when you fragment something, there's always the danger that different numbers will be used by different people for different parts of the financial statement. The feeling is that somebody has to take the overall responsibility for a coordinated set of financial statements.

MR. FRIEND: I would like to complicate the problem further by pointing out that the actuary needs to look at the asset side of the ledger as well. When the accountant looks at the assets, for example, of a pension fund, he's mostly concerned with market values. He'll perhaps concern himself with other measurements as well, but market value is probably the most important characteristic.

The actuary is very concerned about the fluctuation problem that Herb mentioned before. Our training is designed to try to remove aberrations or to smooth. Smoothness is a philosophy which is in many ways diametrically opposed to the accountancy or the auditing view which is, "What are the conditions and the actual facts today?" We have a real dichotomy of viewpoint on this and so, when the actuary looks at the liabilities, he must also look at them in relationship to assets from <u>his</u> point of view.

MR. TRAUTLEIN: I would just mention that a former senior partner of our firm stated that "Accounting in periods as short as one year would be indefensible if it wasn't indispensable." As you may know, the SEC just rereleased their provisions for involvement of auditors in interim reports. So we have short-term as well as long-term measurement problems, and we have to be aware of them both.

MR. LANGER: I think that the accounting profession may be trying to take on too much responsibility. I just wonder if it wouldn't be discharging its responsibility by saying that all opinions, whether actuarial or geological or legal, are really rendered by competent people. I can't possibly conceive how accounting firms can take on the responsibility for every single item in the audits that they perform.

For example, one clear-cut case, even more clear than with actuaries, deals with the securities being held by a bank. I think that, when a bank renders a statement and claims that it has all the securities on its premises, most CPA's will generally refrain from going in and counting the securities physically. So there is reliance in that case upon a bank. I think that the accounting profession would be well-advised to consider accepting the opinions of people with acceptable credentials and not really try to assume too much responsibility which may not be good for itself over the long run.

MR. TRAUTLEIN: That's exactly one of the points that this Cohen Commission is considering. What is our role? Of course, up to this point the evolution has all been the other way. Perhaps some body like the Cohen Commission can come out and reverse that, and maybe the public interest would be better served. But the real world isn't that way at this point.

MR. ROBERTSON: It's really not the accounting profession that's putting the pressure on this issue to have one particular firm or organization take responsibility for the statement. It's the regulatory bodies. They don't want to see a statement that says, for example, an accounting firm has audited all aspects of the financial statements except the effect of certain lawsuits on which they are relying on the opinion of the lawyer, and certain other items on which they are relying on the opinion of the company's accountants, and so on. It's the stock exchange and the SEC that are saying that is not acceptable.

MR. KENNETH R. MacGREGOR: I couldn't help but noting Mr. Trautlein's comment that the auditor must take responsibility for the entire statement, as the auditor in practice in the United States is apparently required to do. I just wonder, nevertheless, if the actuary does err in some respect and things go wrong, when and to what extent will the auditor take responsibility?

MR. TRAUTLEIN: It's for this very reason that the accounting profession has on its agenda a project to define what our responsibilities are in using the work of non-accounting specialists. The court cases tell us that if we use the incorrect work of somebody else we may have a cause of action against the other professional. But, at the same time, we cannot duck the responsibility.

Once again, either we are going to examine complete financial statements or we're not. If we're not, somebody else is going to do it because the public wants it done. It's not the accounting profession that is seeking increased responsibilities. We sometimes try to duck them, but they're being thrust on us by the regulators, by law, and by the courts. I would be untruthful if I said that I saw any imminent reversal of this.

MR. WEINSTEIN: When I was with a life insurance company, one of my jobs was to put together Exhibit 8. I would like to confess at this time that at no time during my employ in that company did I ever have any tangible evidence that the company ever insured anybody. I never met the insureds. I never corresponded with them. I saw lists of policy numbers, but I had no tangible evidence that the policies were in force. Of course, internal auditors had those responsibilities. It would be highly inefficient for me to go wandering around the application file room determining whether this guy lived, or this fellow had perhaps cashed in his policy five years ago.

More recently, I have noticed that, when an accounting firm is auditing an insurance company, one of the newer employees is usually given the task of examining a long list of policy numbers and trying to determine where the insureds are, and whether the policy is in force.

Under no circumstances would I, as an actuary, ever want to do that job. If we are going to say that it is the actuary's responsibility to audit these reserves, then we are taking upon ourselves a function that we are not prepared or qualified to do.

MR. JAMES F. A. BIGGS: Barry was questioning whether the actuarial profession is quite as unanimous in its opinions as Ed suggested. I think one thing on which pension actuaries are absolutely unanimous is in their resentment of what they perceive to be intrusion by the accounting profession into their area. I think what bothers me is that, at least in the beginning, actuaries resented the Audit Guide for Insurance Companies. Yet the accounting profession didn't learn anything from that experience and did the same thing in the Audit Guide for Pension Funds. Clearly, I think both professions need material in their basic educational processes which will make the actuary know what the accountant is doing and why he is doing it, and in turn help the accountant to know what the actuary is doing and why.

With regard to the commission which is looking into the question of the use of non-accounting specialists, are there any such specialists on the commission? In particular, are there any actuaries who have input before the decisions are made?

MR. TRAUTLEIN: No, the committee is a committee of the profession, so there wouldn't be any other disciplines recognized. However, we do intend, before any kind of a formal exposure process, to expose their findings to the actuaries and other professions. I must say that, at this stage, it appears that the conclusions there are going to parallel those in the Life Insurance Audit Guide.

MR. RAYMOND B. KRIEGER: There are two ways that I'm trying to be helpful as an actuary to the accountants in my firm. One way is by providing them with assistance and expertise in their audit of the actuarial portions of the financial statements. A second way is by holding classes and seminars for members of our firm and for small CPA firms. For instance, in this pension area, we've given some seminars on ERISA and we're coming up with a session concerning the interpretation of actuarial statements and reports. The nomenclature is so complex that some of the accountants both in and out of our firm ask some really ridiculous questions. Because it's a completely separate discipline, we go into basic definitions such as the meaning of accrued liability, vested liability, and so forth. Our experience in the last two or three years has been good. The auditors have been using us effectively to assist them in understanding more of what goes on in insurance companies.