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ADJUSTED EARNINGS

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5. The actuary's role as an adviser to nonactuarial groups seeking to establish a method for adjusted earnings.

MR. MELVIN L. GOLD: The accounting practices of life insurance companies differ in certain important respects from those of other industries because of the prime concern with solvency rather than with profits. The principal departure is that the "capital" investment made to acquire business is charged against income in the year it is made rather than capitalized and then amortized over the expected lifetime of the income-producing asset.

Because of these practices, adjustments are often made to statutory earnings in order to calculate earnings on a basis similar to those of other industries' accounting principles. This is usually done in order to analyze the year-by-year operations of a company and to compare its performance with other companies both within and without the industry.

It must be emphasized that any representation of true earnings is, of necessity, an estimate. No one knows how the actuary's estimate of a company's future mortality, investment return, persistency, and expenses will compare with reality; we are only making an educated guess.

The actuary uses a prospective approach—which adjusts earnings by adding the increase in value of the company's in-force business. In essence, he is estimating the increase in the company's net worth. An accounting or retrospective approach adjusts earnings by capitalizing the investment in new business and recalculating reserves on an "experience" basis. It is to this estimate of earnings that the investment community applies a price-earnings ratio.

The specific method used will depend on the purpose of the study, the information available, and the time and money apportioned. Because of the paucity of information available, adjusting earnings and calculating net worth from the Convention Blank alone are sometimes an exercise in futility.

These two terms—"adjusted earnings" and "increase in net worth"—are not interchangeable and are certainly not equivalent. Unfortunately, some analysts have confused these two fundamentally different concepts.

MR. CHRISTIAN L. STROM: It is rather strange that a business as old and as large as ours should get concerned about this subject—that we really do not know the actual earnings of our companies. Because of our type of business, statement earnings are unrealistic, but perhaps there is middle ground between the conservatism we have grown up in and any overstatement of earnings which may be developed.

I believe that adjusted earnings for life company management could be and would be a very useful measure, particularly for the noninsurance-oriented director. It is a little difficult for him, I am sure, to visualize that the company can earn more money in a year in which new production decreases than in a year in which new production increases. Some uniform method of establishing adjusted earnings would aid this sector immeasurably.

With the advent of the holding company concept, it is becoming more urgent that some method of adjusted earnings for a life company be established. A holding company can have in its ownership, among other properties or companies, a casualty company. In the accounting fraternity, generally accepted accounting practices include adjustment of earnings over statutory earnings in a casualty company. The generally accepted accounting practices provide for adjusted earnings which include the excess of unearned premium over expected claims, expenses, and taxes.

This would enable the investor to make a more understandable comparison with other industries. An investor, who looks at the results of a casualty company and a life company, sees that the casualty company has adjusted its earnings and the life insurance company has not; he tends to view this as showing that true earnings of both companies are being shown, that is, there is no adjustment necessary for a life insurance company. I believe we have a responsibility to our investors to tell them as adequately as possible what their company is earning.

For the investment community, showing adjusted earnings for a life company would make possible a more intelligent comparison among companies. Two companies can show the same statutory earnings, but their potential for future earnings may be quite different.

The accountants, security analysts, and the actuaries are all interested in the subject of adjusted earnings. The ideal solution would be an agreement by which all three groups would settle for the same method. Hopefully, one of the groups can agree on a method which perhaps can lead the way eventually to a compromise such that the three groups can agree sooner than we expect. We are all, I believe, fairly well agreed on the type of adjustments that should be made in adjusting the earnings. The degree is the more difficult thing.

In developing adjusted earnings for life companies, it is essential to use material available or, at most, those figures that can be easily determined. Companies are not willing or able, generally, to make long and lengthy calculations for data requested by analysts. Hence, we must attempt to use what we have at hand or is easily obtained.

It is quite evident that equalization of the various reserve bases used by companies must be made. It would seem that the most uniform adjustment that could be made would be for the companies carrying reserves on a preliminary term basis to revalue as though they had made an 818(c) election for income tax purposes, even though they would not necessarily use it.

As for an adjustment in the mortality basis for reserves, I do not believe it is possible. The analyst would have an extremely difficult time making such an adjustment, and in the long run it would have less effect on earnings than the interest basis or reserve basis.

To the nonactuarial analysts the adjustment necessary for interest merits an equal place with the adjustment for expenses. The analysts have suggested, and I believe will use, the method adopted in the Life Insurance Income Tax Law, using a ten-year average rather than the five-year average permissible in the formula. One of the difficulties with this method is that in times of increasing interest rates the increase in reserve from year to year is less than it should be because of the change in interest rates, and in times of decreasing yields the increase is more from year to year than it should be. Perhaps the most realistic rate is that rate used by the actuary in the calculation of his gross premiums. This would require giving information which a company may hesitate to do.

There is, it seems, general agreement on the capitalization of first-year expenses. It is possible to identify certain items and percentages of some items from the annual statement which relate directly to the production of new business. Based on the company's persistency, these could be amortized over the average lifetime of the business. Because of the variation in lapse rates between companies, an average lapse rate would not be suitable. The individual company's rate would be required.

A company doing participating business will generally adjust its earnings for this block of business. The usual contribution made to shareholders by the participating department is 10 per cent of the profits before dividends to policyholders. This varies by statute as well as by individual company bylaws.

A gross premium valuation is most feasible for setting forth the net worth of the company. By comparing the net worth from one year to the next, one can determine the performance of the company comparable to the adjusted earnings. It could be a very useful tool, also, in determining the performance of certain segments of the company as to their true profitability. As an example, a company doing both brokerage and career-type business could determine the profitability of one type over the other.

In all of what we have been saying, it is implicitly assumed that this applies only to a stock life insurance company. There is the equal possibility that adjusted earnings could apply to a mutual company also. If adjusted earnings were applied to a mutual company, would the policyholders of a mutual company demand better treatment in their dividends being paid currently?

As a negative aspect, we must also consider the possibility that the Internal Revenue Service may change its position to reflect adjusted earnings in our tax return. This appears rather remote, but it is a possibility.

MR. ROBERT S. YODER: Different groups for different reasons want to know the true earnings of a life insurance company.

Management wants to measure the impact on earnings of a significant change in the rate of placing new business on the books. The goal of management is to manage earnings. An understanding of the high cost of new business is essential in order to accomplish this goal.

The investing public wants to adjust for that anomaly of the life insurance business that seems to penalize the management that is too successful. A company may be so successful in writing new business that it wipes out any chance of showing an earnings improvement. The investor says that an adjustment must be made.

The question of what the true earnings of a life insurance company are seems to invite a complicated and intriguing answer. The first reaction is to look for every conceivable reason why existing information is misleading.

The actuarial profession has pointed out the long-range nature of the business, the historical development of life insurance earnings, and the factors that will influence the way future profits will develop. They talk of expense, interest, lapse, mortality and reserve adjustments, gross premium valuations, present value calculations, and profit projections.

The accounting profession has pointed out the number of different areas where life insurance accounting differs from generally accepted accounting principles. They talk of nonadmitted assets, capital gains, deferred taxes, market over book, and other items.

As a background to these discussions it is alleged by analysts and others that the life insurance industry has failed in its efforts to communicate with the stockholders and/or analysts on the subject of adjusted earnings. This failure, which they say must be shared by management, the actuarial profession, and the accounting profession, has had its impact on the performance of life stocks, which has been dismal. In fact the claim has been made that the confusion that exists about reported earnings of life companies has driven the investor to areas other than life insurance stocks for investment.

The question is: How can the life insurance industry communicate best with the stockholders about their earnings? Is the actuary communicating when he talks about present value calculations and gross premium valuations, and is the accountant communicating when he talks about deviations from generally accepted accounting principles?

Possibly we are expecting our public to understand too much about the life insurance business. The high cost of placing business on the books probably has the best possibility of being understood by our public. In other words, we should limit our efforts at communication to determining a method of adjustment for the high cost of placing business on the books.

Many individuals have recommended a general method of adding back to earnings a portion of first-year expenses. The portion would be in direct relation to the ratio that in-force gain bears to new business. The details of the method would take some work, and a lot of co-operative effort would be required on the part of the companies. The degree to which adding back first-year expenses is an accurate technique depends on whether these expenses were reasonable costs and whether the persistency of the business proves satisfactory. Such a method has the distinct advantage of being communicable to our public. The disadvantage of such a method is that it carries the danger of the public's becoming disturbed over the high "front end" cost. Too much emphasis on these costs might invite unfavorable public reaction.

On the subject of industrial insurance, rather than examining it as a line of business, I have used this opportunity to look at the debit system as a marketing concept. This will include both industrial debit and ordinary debit sold by this marketing system—in other words, the combination company system of marketing.

If we could accurately measure all elements of the costs of placing business on the books, we would undoubtedly find that the most costly aspect of the life insurance business is prospecting. Prospecting costs are intended to mean the time spent in cold calls with prospects, leading to the sales interview. While such time is unremunerative from the point of view of the agent, it is a definite cost of the selling process. In other words, the agent would not spend the time prospecting (unremunerated) if the rewards of selling were not adequate to pay him for both prospecting and selling.

Under the combination company or home-service debit system of marketing, an agent has a book of policies assigned to him for service. Every customer of the company, within a given geographic area, is assigned to this agent. He performs the service involved with collections, loans, claims, changes, and sales. Collections are made in the home at least once a month. The very exposure to this service function and the frequency of it will help the agent's sales, and the continuous contact will bring leads and further exposure to sales. Under such a setup the prospecting costs will be less than they are when this exposure is not present. It is, of course, not possible to put a price tag on the advantage of such a system, but the efficiency is there to be reflected in earnings.

One index which might have some significance as a measure of this factor would be the average number of policies serviced per agent. Another way to look at the same thing would be to determine the relative number of policies in force per given amount of insurance in force. For example, there may be ten times as many weekly debit policies or three times as many monthly debit policies per given amount of insurance in force as there are regular ordinary insurance policies. Such an index would have to be adjusted for any inherent difference in lapses among the three lines, but it would point up the fact of greater policyholder exposure per $1,000 of insurance in force for business sold on the debit.

What this discussion does is to toss one more index into the arena of adjusted earnings (along with amount in force and premium volume), and that is policy count. Certainly the company that is showing ordinary life volume and premium gains but little or no gain in number of ordinary life policies in force is not developing long-range potential.

This points out the double advantage of a debit book of business: (1) to produce current profits and (2) to provide exposure and prospects for ordinary life sales.

It might be claimed that part of the acquisition cost under the debit system is absorbed in service cost, thus making for less effect on earnings. The combination company system is not unique in possessing marketing advantages. Other marketing systems which may enjoy selling cost advantages are the following:

1. *Multiple line companies.*—Marketing through allied lines, such as life insurance, accident and health insurance, fire and casualty insurance, and group lines. The theory is that one line helps another. The selling cost of each individual line is less than it would be if it existed as a separate entity.

2. *Specialty companies.*—This includes captive markets involving group ordinary, salary savings, and other quasi-group arrangements.

I have not answered the question of what adjustments should be made specifically for industrial insurance. Generally the adjustment given for industrial is less than that for ordinary. If there is a monetary value that can be attached to the marketing advantage discussed, the adjustment for industrial may enjoy a relative advantage in comparison with other lines.

MR. WILBUR H. ODELL, JR.: The actuary's role as an adviser to non-actuarial groups seeking to establish methods for adjusting earnings encompasses at least the following elements: (1) articulating the philosophy underlying the annual statement and insurance accounting; (2) indicating pitfalls which may be inherent in currently used methods of adjusting earnings; (3) taking the initiative in developing methods of answering the questions of others about our annual statement and insurance accounting.

1. The philosophy underlying our annual statement and insurance accounting is one of concern with solvency. This concern, although often overlooked in discussions of adjusted earnings, is of very real and practical importance.

First, we will not know the total value of benefits provided and expenses incurred for a given block of business until long after it is issued. The expected outcome may be expressed in terms of probabilities. The true outcome will not be known for many years. When a block of business is placed on the books, we may expect a profit, but the actual result may be a loss. For this reason, our financial statements should provide, to the extent reasonably possible, against the possibility of adverse experience. This principle has been recorded many times in the *Transactions*, most recently by Mr. Thomas P. Bowles, Jr., in Volume XIX on page D499.

Second, the solvency of each insurance company is the concern of its competitors. To a large extent, the product we are selling is financial security. If insurers of significant financial stature were to fail on even rare occasions, we could not market this concept of financial security.

2. There are a number of pitfalls inherent in currently used methods of adjusting earnings.

In the first place, it is not entirely appropriate to amortize the acquisition expense for all blocks of business, since some such blocks will not be profitable and can be expected to generate a loss rather than a profit. Such a circumstance should be very rare, but its possible presence should be taken into account.

Second, it is not at all clear what the acquisition expense is. An accountant desiring to capitalize and depreciate the "cost" of a piece of machinery is not faced with too difficult a task in defining this cost. But what is the acquisition price of a set of business? There is not even a method of determining the cost that is clearly superior to other methods. The cost might be based on the assumptions, if any, in the premium calculation and the volume of business acquired. Alternatively, it might be based on a measurement of the actual expense incurred by the company in producing that business. Other methods are doubtless possible. Even if the method of determining the acquisition cost were clear, the values to be used are not. The exact assumptions underlying the premiums for a set of business are not always clear. What really constitutes first-year expenses? Is it clear that all advertising is either first year or renewal? Agency contracts commonly contain rewards for conservation, increase in debit premiums in force, and the like. Are such elements of compensation clearly for production of new business? Are they clearly for the conservation of old business? If a mixture, what part is acquisition cost?

Third, it is easy to be lulled into the impression that the value underlying acquisition cost is firm, real, and definite. Such is not the case. The value is based on a vast nexus of probabilities, including those related to death, lapse, and agency turnover. The value is also subject to the vagaries of future economic conditions. Interestingly, changes in management and ownership, for which reasons adjusted earnings may be calculated, may lead to drastic changes in the value of the acquired business.

Fourth, investors may be misled into believing that the adjusted earnings figure is the basis for cash dividend payments. Mr. John M. Bragg clearly pointed out (*TSA*, XIX, D503) that this is not the case. Only the statutory earnings are available for dividend payments.

Fifth, what provision will be made for taking from adjusted earnings the funds to assure the future solvency of the insurer? Assurance of such solvency is required by the nature of our business. Provision for such solvency is a reasonable and necessary charge against earnings. By various methods, statutory accounting does make such provision. However, it appears most adjusted earnings figures do not make such provision and therefore such earnings data are overstated.

Sixth, adjusted earnings data are sometimes made available primarily to institutional investors. This obviously puts the individual small investor at a disadvantage.

3. Too often our profession has resisted a proposed solution to a problem without taking the initiative in finding the best solution. Our annual statement is not intelligible to the layman. We should work toward the correction of this situation. Certain investors have told us the annual statement does not give them the information they need. However, at this time there is considerable confusion about what information might actually help an investor in making intelligent decisions. When there is more general agreement about what data are needed, it might then be concluded that the statement should be expanded to include additional data or that additional information should be made available in reports to stockholders. In any event, it is the role of the actuary to assist in a resolution of the questions of what data are needed and how they should be presented. We should not remain deaf to the questions of others about our business.

A projection of earnings should be of significant interest to the investor. The current "actual value" of a company is always of importance to the investor. It is a measure of the value which he is obtaining for his investment dollars. By "actual value" is meant a concept similar to that of "adjusted" net worth propounded by some authors. The exact definition is not important to the point at hand but bears further study. It may be through the development and determination of such figures that the actuary can fulfill his role and obligation to communicate with the investment public.

The various sets of adjusted earnings data currently published may be of some use, provided that their limitations are kept in mind. However, for the management of a life company, year-to-year progress can be more easily measured by examination of marketing results, mortality, morbidity and persistency results, the expected profit on new business, and so forth, than by examination of adjusted earnings. The investment community may or may not find the adjusted earnings data of various companies more or less comparable than the statutory earnings of the same companies depending on the circumstances. The investor would be helped by an appraisal of the expected future earnings of each company.

For lines of business other than ordinary life the capitalization of acquisition expense poses even more questions in the case of industrial insurance than in that of ordinary. The extreme case is the company which rewrites its in force each year. Mr. Gold's current paper explains a method of adjusting earnings by adding to them the portion of the current year's acquisition expense attributable to the increase in in force. This method seems more logical for industrial business than capitalizing the acquisition expense.

Group life and health business and the field of pensions are even less subject to generalities. The person not satisfied with the appropriateness of statutory earnings in these lines must be willing to acquire rather personal knowledge of the business written by the insurer.

MR. ANDREW VOGT: My company has for many years prepared a statement each quarter for use by management and directors in the planning and operation of the company. To prepare this statement, all accounts in the general ledger are separated into acquisition and renewal. This includes the premium income items, commissions, claim, and all expense items.

The quarterly statement shows first the renewal earnings developed directly from the renewal items and second a cost-of-new-business figure developed from the acquisition items. The renewal earnings reflect a measure of the continued profitability of the business already on the books. This renewal earnings figure is also reported to holders each quarter as "earnings before investment in new business."

The cost of new business is a measure of success of the agency force in producing new business. This cost can be looked upon as cost paid for placing goods on the shelf. A retail store would not take the profit on the goods at the time they are added to the shelf. Time will tell what profits will result. Similarly, only time will tell what mortality, expense, persistency and, therefore, earnings will result from the business now put on the books and whether the price paid is too high or too low.

In preparing this quarterly statement, we make sure that the net results agree with the Convention Blank. If a few additional items on the Convention Blank, such as expenses and increase in reserves, were separated into first year and renewal, as suggested by Mr. Townsend, the renewal earnings and cost of new business items as outlined could be produced directly from the Convention Blank.

As I stated in the beginning, the setup of our quarterly statement has been designed for purposes of operating and managing the company. It is not designed to measure earnings for evaluating the stock or value of the company. The renewal earnings should perhaps be modified by the cost of new business to the extent of replacing the amount of insurance in force terminated during the year (cost of goods sold). It is suggested that this "renewal earnings" concept with certain modifications would produce more accurate and more consistent results than the concepts of either "statutory earnings" or "adjusted earnings."

MR. ROBERT G. ESPIE: One of the things that I think is bothering us is the term "capitalized acquisition cost." I do not think acquisition costs should be capitalized. I do not think they are an asset. We are losing sight of the real problem when we try to capitalize acquisition costs, because the real problem is created when we set up a reserve which is unrealistic. If we were to set up a realistic reserve, perhaps along the lines of the assumptions in the premium calculations, the results would be much more realistic in the end.

To illustrate this, let us assume there are two companies which are in exactly the same position except that one of them values on a preliminary term basis and one values on a net policy basis. I do not see how we can argue that they have different capitalized acquisition costs. I think the fact that they do not have different acquisition costs is obscured by these differing valuation methods. So, in effect what I am saying is that we could solve most of this problem if we could set up realistic reserves.

The claim by accountants that the life insurance industry is different from other industries in not capitalizing acquisition or set-up expenses is not as justified as it seems at first glance. IBM, for instance, wrote off as expense all the expenses incurred in generating its new 360 series of computers. It did not capitalize the expense despite the fact it was embarking on a product whose profit realization would extend over a period of years. Other computer manufacturers explain changes in earnings in terms of selling more for cash and fewer leases. They are not required to amortize their expenses to measure their earnings.

Other businesses are also involved with the accountants in this problem of earnings. The bankers have practically defied the CPA's. They have said that application by the CPA's of their generally accepted accounting principles is not appropriate and is not accepted by the banking industry. The fire and casualty business is also involved. The principal fire and casualty industry organizations have joined together to notify the CPA's that they do not agree with their accounting guide, which says that unless earnings are adjusted according to a certain formula they are not right.

This whole thing needs a great deal more investigation, more searching, and more basic truths before we go any further. I am afraid I cannot agree, for example, with Mr. Townsend's theory that you can adjust life insurance earnings by operating only on column 3 of page 5 of the Convention Blank. I do not think my own company is unique in this respect, but we had occasion a while back to take on a very large single premium in the group annuity line. The premium calculation for this group annuity was realistic. We used current interest rates, perhaps 5 per cent or more. We had to set up a reserve for it, based on the assumption of earnings, of, I think, $3\frac{1}{2}$ or maybe 4 per cent interest. The result was that column 9 on page 5 showed a negative net gain which needed adjusting just as much as column 3.

It was suggested that, if we were able to show realistic reserves, much of the problem would be eliminated. However, solvency is something we cannot cast aside. Perhaps what we should do is set up realistic reserves, as realistic as management can conveniently make them, and then require that the excess of statutory reserves over realistic reserves be established as additional surplus, which you must have to stay in business.

The problem may be looked at in another way, and that is as one of interim valuations. Our problem is that we are trying to put a definitive value on something for which the true value will not be known for a long time. We must do it conservatively. The fact that we do so tends to distort our earnings. I do not know whether we have much alternative. We do not have the exact information we need. We do have large numbers of tables. We have statistics of all kinds which have varying degrees of credibility in various lines of our business. But essentially we are selling certainties to our customers in exchange for their uncertainties. We take their uncertainties off their shoulders and handle them ourselves. But I do not believe the laws of averages on which we rely are good enough to reduce this uncertainty completely in our own houses. We still have uncertainty, it must be recognized, and it must be recognized with conservatism.

MR. ODELL: The proposal to hold realistic reserves plus an earmarked surplus that in total would equal the statutory reserves is very interesting. One might view this as holding what the actuary considered a realistic appraisal of the company's liabilities and in addition making a needed provision for solvency as required by the nature of our business. The question of solvency was discussed very clearly in Mr. Bowles's paper on surplus published in the *Transactions* (XIX, D494).

He pointed out that, at any time, the surplus of a company must be sufficient to survive significantly less favorable levels of mortality, expense, and interest than those currently being experienced. Some methods now being used to adjust earnings seem to give this concept little weight.

MR. FREDERICK S. TOWNSEND: Mr. Espie pointed out that unrealistic reserves are set up. Another method which has been proposed by some people as a possible solution to the problem of adjusted earnings is that line 17 of the income statement, increase in aggregate reserves, be based on increase in aggregate cash value liability rather than increase in aggregate reserves and that the excess of the reserve increases over the cash value liability be included in surplus.

Not too much has been said about the group or health lines of coverage. As analysts, my company does make some adjustments for individual accident and health insurance but only for those few companies which derive nearly all or a major portion of their premium income from the sale of noncancellable disability income contracts. We feel that the investment in new-business pattern from this type of business by these companies is somewhat akin to the pattern of investment in new business found in ordinary life insurance.

In the area of individual annuity and group annuity we are aware that there are problems, but we have not been able to reach any conclusions on what should be done, especially with respect to group annuities. For individual annuities only one company derives any significant portion of its premium income from the individual annuity line, and we do adjust the earnings of this company to reflect the investment in new business for this line, at least to the extent that its first-year reserves and first-year commissions exceed the first-year premium.

MR. E. FORREST ESTES: I wonder if the root of the problem lies in the tendency of the accountants to assume authority in *all* areas of financial recording, even though there may be some areas in which their competence may be open to question. This, combined with the fact that the accountants greatly outnumber the actuaries and the fact that legal certification of accountants has been established for many years, results in the actuaries finding themselves "outvoted."

When our accountant friends criticize the form of life insurance companies' financial statements, perhaps they need to be reminded that life insurance accounting does not—and cannot—fit the conventional mold. They need to understand that a primary concern of the life insurance business is solvency—not only solvency for the present but solvency for a long time in the future. They need to become aware of the fact that while life insurance accounting may appear to be the child of state supervision it is also true that strict application of basic double-entry bookkeeping methods is, for all practical purposes, impossible. (How would a specific interest income entry be properly allocated on a strict double-entry basis? It cannot be done.) Perhaps they should also be reminded that an accounting, as well as mathematical, background is a must for actuaries, whereas a knowledge of life contingencies is not a requirement for the CPA.

The answer to this appearance of conflict is, of course, a mutual respect between the profession of accountant and the profession of actuary, with each profession recognizing its limitations.

MR. JOSEPH P. McALLISTER: One of the SEC requirements makes holding companies subject to an outside audit. If a life company sets up a holding company, almost the only assets of the holding company, at least originally, will be the assets of the life company. I would guess that the CPA's would make a very strong pitch for having to audit the life company in order to audit the holding company. This is going to give them an entry which the security analyst will not have and a little more of a regulatory role in determining what principles should be applied than the analysts will have.

Incidentally, one of the "generally accepted accounting principles" espoused by the CPA's is the matching of revenue with expenses. I think they would say that the usual preliminary term valuation methods do not do this; such methods give you a way of making allowances for your expenses in the year incurred, but they do not provide a means for spreading the expenses over the years during which the resulting revenue is produced.

I think the amortization of initial expenses is probably less justified for a small new company than for a large company. The primary concern of the young company is solvency, not the spreading of earnings, and for this young company the cost of obtaining the information necessary to identify initial expenses could well be prohibitive. A large company may not want to identify initial expenses in a prescribed manner but could afford to do so if necessary.

There seem to be two elements to this matter of amortization of the cost of new business. One is the amount that is going to be determined as the cost of new business, and the other is the period over which it is spread. With respect to the first element, as Bill Odell mentioned, it is not always feasible for a combination company to determine what the cost of new business is, especially if the company's compensation system is set up in a way which emphasizes increase in business in force rather than "new business" versus "renewal." With respect to the second, it would seem that the line of business and the company's persistency rates would play a large role in determining how the cost should be spread. Should some sort of average amortization period be set up, or should the company's persistency rates be used? If the latter, would the CPA's and analysts want to verify the persistency rates? If the former, would the analysts be satisfied, or would they then look into how the prescribed amortization method applies to the specific company? This approach might produce a more accurate adjusted earnings figure, but it might also lead only to someone's wanting to make another round of adjustments.