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MANAGEMENT REPORTING

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1. The content, frequency, and format of management reports.

2. Budgeting and its role in the planning process.

3. Integration of reporting with the planning process, including treatment of variances from plan, feedback, etc.

MR. JOHN C. ANGLE: The size of the audience at this session is ample evidence of the interest we all share in designing more comprehensive and flexible reporting systems. Those who would successfully manage insurance companies today require far more information than can be drawn from a cash basis trial balance or an accrual basis analysis of operations by line of business modeled after page 5 of the convention annual statement blank. Fortunately today's computer systems seemingly give us the tools to obtain the information we really need if we can but determine what that information is.

Some of the questions that we must scratch our heads about are: What financial information is worth producing? How should it be organized? What significant economic activity can be measured? Can we measure the use of financial resources? Innovation? Human resources? Productivity? Growth? Service? What are the limitations induced by measurement errors and biases and by the use of single valued, essentially deterministic numbers? How well can management reports describe, quantify and communicate significant economic activities? Can administrative costs really be controlled through budgets?

CONTENT, FREQUENCY AND FORMAT OF MANAGEMENT REPORTS

MR. RUSSELL M. COLLINS: Before getting into specifics, I would like to take a few minutes to make a few general comments on management reports. As I see it, there are three major purposes for such reports:

1. To measure the progress of the enterprise, especially in those highly critical and visible areas of sales and profits. There is a general expectation that a successful enterprise will show reasonably steady growth in the sales of its products, and its profits, as measured by net income, net income per share, or other measures as appropriate to the specific type of company.

2. To measure performance against plan in the same critical areas. The plan, whether it be for five years, three years, or one year, is a "road map" for the enterprise. In an effective planning process, management examines many alternative plans for achieving its objectives, both long term and short term.

Assumptions, which represent management's best assessment of current and future business conditions, are used in examining these alternatives. A "best" alternative is selected and becomes the plan for the organization. Other alternatives may be maintained as contingency plans to be used in case certain changes in the business conditions occur. Still other alternatives will be rejected as impractical or not effectively contributing to the achievement of the organization's objectives. In any event, the final plan is inevitably built on several assumptions, about the external conditions in which the enterprise operates as well as internal developments and results of planned activity. It is extremely important that management periodically measure actual results against these assumptions, if the plan is to be successfully implemented.

3. To indicate, as early as possible, significant deviations from the plan, so that action may be taken to correct or adjust to the situation. In this role, management reports act as an "early warning system" to give management the longest possible lead time in taking action. Consequently, it is important that management reports contain timely, actionable information.

These last two purposes for management reports, namely, to measure performance against plan and to serve as an "early warning system" for management, tie management reporting inextricably to the planning process. The utility of management reports increases in proportion to the extent to which these reports link actual results to planned results.

There are several levels of decisions and decision makers in any organization, ranging from operational to tactical to strategic. These do not always strictly follow organizational levels. For example, the agency director often makes decisions at all three levels. He must make operational decisions in the daily management of his department. He must make tactical decisions in dealing with situations which arise in individual agencies. And he must make strategic decisions, in his role as a member of top management, in setting long range objectives for the organization and strategic plans for achieving those objectives. The fact that these decisions do not strictly follow organizational levels complicates the task of report design, since the same person in an organization has need for some or all of these different types of information. Content, frequency, and format of a management report will vary according to whether the report seeks to provide information for operational, tactical, or strategic decisions. For example:

1. Operational reports will generally contain more detail than tactical reports, and, similarly, tactical reports more detail than strategic reports.

2. The time horizon of operational reports tends to be shorter than that for tactical reports, and that for tactical reports shorter than for strategic reports.

3. The scope of the report ranges from generally narrow, in the case of operational reports, to quite broad, in the case of strategic reports.

4. The frequency of operational reports will generally be the greatest, and that of strategic reports the least.

5. The source of information for reports ranges from mostly internal, in the case of operational reports, to more external, in the case of strategic reports.

6. The degree of precision varies with the type of report. Operational reports tend to be the most precise, while strategic reports are probably the least precise.

Rarely is any one report purely operational, tactical or strategic.

I would like to illustrate the above statements with some of the reports which we use in the Penney Insurance Companies. The Penney Insurance Companies are actively engaged in both direct response and agency sales of life, health and casualty insurance. Since most of you are probably much more familiar with the agency operation, I thought it would be interesting to use, as some of my examples, reports in the direct response life and health operations.

1. My first example is an operational report. (Exhibit 1) This first report happens to be one for the claims operation. It is prepared monthly and distributed to the managers in the Claims Department and the vice president in charge of operations. It shows the numbers of different kinds of claims processed, the number still pending, various categories of claims without payment and the age distribution of pending claims. The managers of this function have certain expectations in each of these areas, and this report enables them to be sure that their expectations are being realized.

2. My next example is a report which is both operational and tactical in nature, and pertains to the direct response sales function. The management of direct response marketing receives several marketing evaluation reports each month which compare actual results to planned results. One of these reports, the "Production Volume Analysis" (not shown), gives results both by product and source of business. Sources of business include the Penney credit card customers, cash customers, insurance policyholders, various outside lists, etc. The Production Volume Analysis shows the circulation, number of applications received, number of policies issued and paid, and annualized premium paid and placed for each product and source group, compared to plan. Another report, the "Marketing Cost Analysis" (not shown), compares marketing costs to the "Allowables" in the marketing plan for each product and source of business. The "Response Analysis Report" (Exhibit 2) compares the response rates achieved for each product and source of business to expected response rates assumed in the annual plan. It is important that each product and source of business be on target if the planned results for the year are to be achieved. If any of them is off target, it is necessary for marketing management to either correct

EXHIBIT 1

CLAIMS STATISTICS
FOR OCTOBER, 1976

	MONTH	YTD	12 MONTH MOVING AVERAGE
Claims Opened:			
AD&D			
Life			
Other			
TOTAL:			
Claims Closed:			
AD&D			
Life			
Other			
TOTAL:			
Claims Pending:			
AD&D			
Life			
Other			
TOTAL			
Number of Days Inventory			
Number of Drafts Issue			
Amount of Drafts			
Number of Claims (CWP)			
CWP Ratio to Closed Claims			
Number CWP Pre-Existing Closed Claims			
Number of CWP Rescissions			
%CWP Rescission to Closed Claims			
Number of CWP - Other Denials			
%of CWP-Other Denials to Closed Claims			
Number of CWP - No Claims			
% of CWP - No Claims to Closed Claims			

PENDING ANALYSIS

AGE OF PENDING	TOTAL NUMBER PENDING	% OF PENDING	% OF PENDING 12 MO. MOV.AVG.	INCLUDED IN-TOTAL LIFE	NUMBER AD & D	PENDING LEGAL
0-30 (days)						
31-60						
61-90						
91-120						
121-150						
151-180						
Over 180						
Totals						

EXHIBIT 2

RESPONSE ANALYSIS - HOSPITAL

	Response Rate	Budgeted Response Rate	Circulation Cost Per 1,000 Actual	Circulation Cost Per 1,000 Budgeted	Circulation Cost Per 1,000 % of Budgeted	Issue Rate % (Issue ÷ Apps Received	Budgeted Issue Rate	Paid Rate % (Paid Issues ÷ Issues)	Budgeted Paid Rate	Average Monthly Premium	Budgeted Average Monthly Premium
841 - Non Can											
JCP Credit Card List:											
Direct Mail - initial											
Direct Mail - follow up											
Inserts											
Policyholder File - Credit Card											
Active											
Lapse											
Policyholder File - Direct Bill											
Active											
Lapse											
838 - Guaranteed Renewable											
JCP Credit Card List:											
Direct Mail - initial											
Direct Mail - follow up											
Inserts											
Policyholder File - Credit Card											
Active											
Lapse											
Policyholder File - Direct Bill											
Active											
Lapse											
Outside Lists											
Full Premium											
Introductory Premium											
No Money											
Surgical Rider - Add On											
Policyholder File - Credit Card											
Policyholder File - Direct Bill											
Intensive Care - Add On											
Policyholder File - Credit Card											
Policyholder File - Direct Bill											
Hospital Daily Benefit Increase - Add On											
Policyholder File - Credit Card											
Policyholder File - Direct Bill											

the situation quickly or implement a contingency plan which will make up for lost business, cost overages, etc. Thus, the Response Analysis Report is not only a report on operations; it provides marketing management with important information for the tactical decisions which are sometimes required to assure that the sales and earnings objectives of the operation are met.

3. While direct response marketing management needs quite detailed information in order to make its management decisions, company and division management do not require nearly the same detail. However, they do require enough information on direct response marketing so that they can be assured that the overall company objectives in this area are being met. My next example is a page from the report which company management receives from direct response marketing operations. (Exhibit 3) This is a monthly report, and compares actual to planned results in much broader categories. From this report, it is possible to see how direct response marketing is progressing, by broad product groups and major market segments, against plan. A narrative accompanies this report, in which direct response marketing management indicates problem areas and the corrective action which is being taken. The detail contained in this report is not sufficient to indicate the specific problem areas. It is direct response marketing management, not top management, that needs the type of "diagnostic" information contained in my previous example.

4. Strategic reports cover a broad spectrum. Common examples of such reports from external sources, all of which are needed by top management to make strategic decisions for the enterprise, are economic forecasts, reports on legislative and regulatory activity, consumer research reports, and even the morning newspaper. I will take one example from our Penney Insurance Operations. A couple of years ago, we were faced with the question of whether we should adopt the identity of our parent, JCPenney Company, or a separate identity, as Allstate did. To help us make that decision, we decided to do some consumer research. In simple terms, this research identified those qualities which consumers consider important in an insurance company, and then tested the consumer identification of these qualities with various possible company names, some including the JCPenney name and some not. The results of this research was important input to the decision to adopt the JCPenney name for our insurance companies.

5. Probably the best known strategic management report of an internal nature is the financial statement. The management of our Penney Insurance Companies receives financial statements on a monthly basis. In contrast to the statements provided to directors, the reports to company and division management are quite detailed. They include results by line of business. In this regard, we believe that financial results of line business are most useful when reported on a marginal basis. By this, I mean that we separate out the investment income on capital funds. Other

EXHIBIT 3

MONTHLY MARKETING REPORT SUMMARY - LAM DIRECT RESPONSE

ALL PRODUCTS
Actual vs. Latest Plan Forecast

DECEMBER, 1976

	PENNEY CREDIT				POLICYHOLDER							
	Solo		Insert		Cross Solicitations		Rider		Out List		Total	
	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan
(a) Marketing Cost*												
(b) Circulation (in 1,000's)												
(c) Apps												
(d) Policies or Riders Issued												
(e-1) New Annualized Premium Volume												
(e-2) Cost/per $100 New Ann. Prem.***												
(f) Total Premium Income												
Life												
A & H												
(g) Policies in Force												
(h) 13 Month Persistency Ratio**												
(i) Other Marketing Cost Admin/Staff/Fees/etc.												

*Advertising and other variable cost (as contrasted with (i))

**Latest completed quarter

*** $\frac{(a)}{(e-1)}$ 100

companies that I am familiar with also separate out general overhead expenses, on the basis that the allocations of these are arbitrary, at best, and that such allocations to the various lines of business only detract from the value of these by-line reports. We do not carry the marginal approach this far, but do believe that the marginal approach best measures the contribution of individual lines of insurance to the overall results of the company. We consider GAAP statements the most useful to management, although we do report statutory net gain from operations and surplus quarterly.

I hope that these examples serve to illustrate various types of reports, and the requirements of each.

Before concluding my remarks, I would like to spend a moment to discuss expense reporting. Certainly, in the inflationary economy in which we find ourselves today, especially as vendors of a product for which the price is fixed for many years in the future, expense is a most critical area. If life insurance management cannot continue to find ways to improve productivity, our survival may ultimately be at stake. Gains in investment return and mortality no longer provide the cushion against increasing expenses which we once enjoyed. If we are to hold the line in the expense area, we must provide timely reports to those managers who are in a position to take quick action. These are the managers of the "cost centers" of the company (the cost centers are there, whether or not we identify them as such). If expense reports are to be of optimum usefulness to these managers, they must not only show actual expenditures against budget, but should also relate the expenditures to productivity. That is to say, the budget is based on the levels of activity which are <u>assumed</u> by management to prevail for the coming year at the beginning of that year. Circumstances have a way of changing. For example, the sales department may get hot and the volume of new business may double. This makes the underwriting department expense budget inadequate for the volumes of applications being received. If the manager of the underwriting department has unit costs- both planned and actual - at his disposal, he is in a position to better know (a) how to adjust for the increased volume, and (b) whether or not in doing so he is maintaining satisfactory levels of productivity.

BUDGETING AND ITS ROLE IN THE PLANNING PROCESS

MR. WILLIAM B. WAUGH: The words "management report" and "management information system" carry different meanings to different people. To some they mean information for top management and, therefore, include only those reports going to the President of the company. On the other hand, management reports can mean statements with information to help anyone who manages, from the President down to the first line supervisor. I am much more comfortable with the latter definition, and that is the one that I intend to follow today.

I think it has to be recognized that the information provided at each level must be what the manager needs, and what he recognizes he needs. There have been some very sophisticated management information systems developed which have produced data that was not used. One example was recently reported in a Toronto newspaper as follows:

"The Ontario Government spent about $9 million on a sophisticated computer analysis system, affectionately called the mouse trap, and designed to assist community colleges in compiling data and estimating planning needs before cancelling the system in 1975.

"The amount of information produced by the system was so vast, and the information so detailed that using it became a nuisance. According to Philip Adams, Ontario deputy minister of Colleges and Universities, some colleges felt they could do better on the back of an envelope.

"The system has now been replaced by a more modest version which will be easier to operate and which carries a price tag of only $375,000 a year. The old system, which was scrapped in 1975, had cost the province $2 million a year since 1971."

I think a good rule is that information should be prepared only where action may be taken as a result of its preparation. If we followed this rule, a great deal of paper flow in the office would be cut out.

Reports can be considered to be of three types:

1. Scheduled reports, which are prepared on a regular basis;

2. Exception reports, which are prepared when some defined condition occurs;

3. Demand reports, which are prepared on request.

I am dealing today with budgeting, primarily expense budgeting, and with scheduled reports prepared in connection with it. To budget expenses properly, the total company budget for all items must be considered.

Budgeting affects all levels of the company. The best budgets are prepared in a top-down, bottom-up fashion. Top management starts by setting broad objectives for the budget period in question (which I will consider here to be one year). Different companies do this in different ways. In some companies, a number of senior executives get together undisturbed for a few days to hammer out the broad principles. In others, the President comes to his conclusions in solitude, or after reviewing matters with his advisers. In a few companies, direction may come from a parent company.

In any case, broad guidelines are prepared, set out in a scenario, and communicated down the line to all those who manage and prepare budgets. These can be in the form of a general statement of objectives for earnings, production, expenses, etc. (Exhibit 4) A scenario of business conditions (Exhibit 5) may also be included.

In preparing his budget, a manager at Canada Life has the following information in front of him:

1. His costs of last year

2. His year to date costs

EXHIBIT 4

1975 Corporate Goals and Targets

Total Company Summary

I. CORPORATE GOALS:

A.	Percentage Increase in Statutory Earnings	6.7%
B.	Percentage Increase in GAAP Earnings	9.2%

II. TARGETS:

A. Marketing Targets:

1.	New Annualized Premiums (Expected):	
	- Agency Sales Division	4,900,000
	- General Agency Division	1,400,000
	- Combination Division	7,975,000
	- Group Division	7,260,000
	Total	$21,535,000
2.	Marketing Expenses:	
	- Agency Sales Division	$ 3,809,412
	- General Agency Division	823,594
	- Combination Division	6,158,909
	- Group Division	605,876
	Total	$11,397,791
3.	Marketing Expenses/New Annualized Premium Dollar (2) ÷ (1):	
	- Agency Sales Division	$ 0.78
	- General Agency Division	0.59
	- Combination Division	0.77
	- Group Division	0.08
	Total	$ 0.53

B.	Net Investment Income Target	$36,967,000
C.	General Expense Target (Budget)	22,149,000
D.	Federal Income Tax Targets:	
	- Statutory	4,826,000
	- GAAP	8,124,000
E.	Statutory Earnings Target	12,287,000
F.	GAAP Earnings Target	19,476,000

EXHIBIT 5

1976-1977 Planning Assumptions

1. The industry premium volume will increase by 13-15%.

2. The stock P/C industry operation ratio will exceed 100 in 1976 and return to approximately 100 by year end 1977.

3. Industry-wide adjustments during 1975 will lessen the problem of market capacity shortage in 1976.

4. Continuing steady, but slow decline in market share for independent P/C agency system.

5. Intense competition for good quality business.

6. Personal lines will continue to represent about one-half of the P/C market.

7. Greater complexity of risks and increasing service requirements of the commercial market, including increasing demands for risk management services.

8. High probability of Federal no-fault standards legislation before the end of 1976.

9. High probability of some form of national health legislation before the end of 1976, effective 1977-1978.

10. High probability of the establishment of minimum standards for workers' compensation by the end of 1977.

11. Removal of major deterrents to true group market development by 1980.

12. We will be required to participate indirectly in the malpractice market through state facility operations.

13. Continued increasing governmental influence on our industry.

14. Government contracts and/or state regulatory agency action by 1976-77 may result in a mandatory affirmative action program.

15. Inflation rates entering 1976 will be lower than in the recent past, but concomitant economic recovery and governmental stimulation of the economy in 1975 could result in a new round of high inflation.

16. A resurgence of inflation in 1976, an election year, could result in the reimposition of some form of Federal price controls.

17. Short term interest rates will follow inflation rate trends.

18. Unemployment rates will decline gradually but will remain at unusually high levels into 1977.

19. Resurgence of economic strength begun in 1975 will support continuing growth in the national economy.

20. Gradual improvement in the housing industry and increased plant and equipment investment.

3. The guidelines for next year

4. His knowledge of future plans of the company

Expense budgets in different companies are prepared and monitored by:

1. Cost centre - where designated areas are arbitrarily defined as cost centres, or,

2. Department - this is effectively defining cost centre as department, or,

3. Total company budget. In this case, figures are prepared by various individuals, but only total company figures are monitored.

At Canada Life we use the cost centre method, having over 200 cost centres. Each cost centre receives the necessary information and prepares its own budget.

Here is a sample of a Canada Life cost centre. (Exhibit 6) There are a number of items which do not fit into a cost centre, but are general expenses. These are budgeted by the individual who controls them. All budgets go through a divisional head, who reviews the budget and is expected to be sure that all expenses are justified. He has in front of him the same information that the manager had, plus a broader perspective.

This information is all assembled to produce the full company budget, which is sent to top management for review relative to the initial guidelines. The budget is also used in the earnings calculations, which by now will have reached a final stage. If the results are not satisfactory, management refers the budget back to cost centres for the necessary changes. The final budget is now approved, printed and disseminated.

At Canada Life, information to monitor the budget is prepared monthly but only distributed quarterly. Each cost centre receives a quarterly expense report showing how its expenses are running against the budget. In addition, summarized budget totals are prepared for divisional managers, who can see how the total budget is going.

The information goes to those who are expected to do something about it. If an item is running over budget, the cost centre is expected to bring it into line. At the divisional level, the budget is expected to be met for division expenses, although there are allowances for overruns due to sales or expenses outside the division's control. These reports keep each cost centre, and top management, aware of how expenses are going through the year.

At the Canada Life, the expense budget reports are prepared by a computer system. The budget estimates are coded and fed into the system when received by the budget department. The prior year's figures have been retained in the system. Expense figures flow through our computer accounting system, into the expense system, to produce the reports. The system has query capabilities, so that special reports can be produced on demand fairly quickly. The system could easily produce exception reports, but we have not yet settled on exactly what the criteria should be for such reports.

EXHIBIT 6

H.O. COST CENTRE BUDGET REPORT

109 Translation Services

June 30, 1976

	To The End of June 1976					Full Year	
	Actual	Expected	Dollar Variance	Pct. Y-T-D	Variance Prev Quar	1976 Budget	1975 Actual
Books							
Staff Salaries							
Overtime							
Supplies							
Printing							
Telephone Long Distance							
Subtotal							
Rent							
Telephone Rent							
Total							

The information in the budget computer system flows into our functional cost computer system. Many of the expenses entering our functional cost system include a functional cost code. Time allocations and volume counts are also fed into the system. The computer system splits our expenses as required for our annual statements. Since we operate in a number of countries, splits for many statements are required. In addition, expenses are divided by volume counts to give us unit costs for each function. The system prepares reports of these unit costs in a form suitable for use in calculation of premium rates and dividends. This is an important use of the figures.

In addition, the unit cost figures give us standards of comparison. They can be traced from year to year to give us a trend from which to conclude whether or not our progress is satisfactory. Some companies also use the unit costs as a check on the reasonableness of the annual budget. By projecting both unit costs and volume counts, it is possible to calculate amounts to compare with the budget prepared as I have outlined above. For plans beyond a year, unit costs give us a method of forecasting expenses that may be superior to projecting all individual expense items.

Many companies are now using the LOMA Intercompany Unit Cost Expense Study to see how they stand relative to other companies. This comparison can point out areas where their expenses are high and, hence, where they must make a conscious decision to reduce or justify them. The Canada Life has contributed to the Intercompany Unit Cost Study since it started, and regularly compares these costs with a number of Canadian companies similar to us. We feel these reports are very worthwhile.

INTEGRATION OF REPORTING WITH THE PLANNING PROCESS

MR. ROBERT B. GOODE, JR.:* My role on this panel is to tie in the reporting of results with the planning process. By way of background, my company, The Hartford Insurance Group, has been into business planning for a number of years, and was into business planning before the acquisition of our company by International Telephone and Telegraph Corporation. We felt that we were doing pretty well in our business planning process, but adding the ITT expertise on top of ours resulted in what I would consider to be one of the most sophisticated insurance business planning systems in the trade.

I know there are many other workshops and panels regarding setting of plans at this meeting, but I don't intend to discuss them in any detail. Our style is to set our business plans and, in no uncertain terms, to live with them. It works.

I won't go into setting of the plans or goals, but will concentrate on the next step, the one that is most neglected in the cycle, which is measuring results against the business plan. This process is typically done for the current year, but a step that I consider important is to look at the plan set five years ago, and compare this year's results with that plan.

Most of us start our planning with our sales organizations and, of course, that's the obvious and really the easiest example of setting a plan and then monitoring the plan to compare results with the plan. It's a way of

*The charts referred to in the text are not reproduced here because they are proprietary. However, the text should be self-explanatory.

life for good sales management, and is necessary in following new agents along their validation schedules. But more important is the business plan for the total corporation, and the monitoring of the results against that total corporate business plan.

It's my view that we've been a great deal easier on ourselves than we have been on our sales organizations, because it's so much easier to compare sales results with plans than it is to compare total corporate results with plans. Therefore, I consider a major challenge to be integration of the results for the total company with the plan - not just with the sales process.

At ITT, and also at The Hartford, business planning is conducted through a series of seemingly endless meetings held at least quarterly. The focal point is a business planning meeting in the fall at which the next year's plans are set. Very briefly, the cycle begins in the spring with the first cut at next year's results. Those are then distilled through the summer and cast in concrete in the fall. At the same time there are a series of review meetings looking at the results for the year to date and comparing them with plan. This is the focus of my section of this panel, and I do have some pretty strong thoughts on the matter.

Many of us who have grown up in the life insurance business have felt that comparing results for periods less than one year make no sense except, of course, for our obvious example, the sales organization. I think this annual look mind set was really conditioned by the difficulties of calculating life insurance policy reserves on an interim basis, but with our data processing magic we have been able to solve those problems. Therefore, it is my opinion that life insurance company results can meaningfully be reviewed quarterly, and there are some key indicators that can be looked at on a monthly basis.

We focus our attentions on our results by quarter. This first chart* shows the format of a document that is the basis for our quarterly review, and most of the indicators we consider are shown. You'll notice that many different sales indicators are shown, including volume, premiums, commissions and the like.

This chart that we have before us is for a single line of business, and we prepare comparable charts for each of our lines of business such as the group insurance and group annuity and variable annuity business. I'd like to take you across the columns because I think the column headings are particularly important in this process of monitoring results against the plan. I have chosen a third quarter review chart, and you'll notice that results for the third quarter are shown as well as year to date figures in Column F. Columns H and J are important for comparison purposes. H is the budget which was set in the fall of the preceding year, and the forecast is a very recent forecast. In this case it would have been set in the third quarter. The two variance columns, I and K, are important, and actually the review meetings involve a discussion of variances. Variance to budget gets a lot of attention, and action plans often develop out of variances. The last two

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columns are full year forecasts and, of course, a comparison with the previous year. You will notice the main focus here is comparison with budget, or in some cases forecast, without particular attention to the preceding year. This is the process of monitoring results against plan.

The line headings are about what you would expect, perhaps a little bit more detail than some companies would want to use. The first seven lines are all premium data, and could be consolidated. There is considerable detail in the lines 11 through 18; again, these could be consolidated if you so chose. Lines 33 through 35 are important since here we are looking at expenses against the acquisition expense assumptions in our rates. The numbers that are monitors are the ratio of acquisition expenses to first premiums on an assumed basis vs. the actual basis.

You'll notice that persistency doesn't happen to show on this particular exnibit. We do look at persistency results against plan for components of our selling organizations, including a lapse index for each sizable agency. That lapse index is compared with expected, and actions are triggered when it gets out of line.

It's one thing to talk about these variances, but it's quite another matter to do something about them. A process that we have found helpful is what we refer to as a profit assurance plan. A profit assurance plan really is an expense plan in the event that production is less than anticipated. For example, if an analysis of variances indicates that life insurance production might be well under what was budgeted, certain expense reduction actions would be required. This profit assurance plan is set forth in a very formal way, and would include specific expense reductions that are called for in event of the production shortfall. That plan is then monitored in the same way that the basic business plan is being monitored. We have used these profit assurance plans, and they are effective since they represent management commitment to action, usually expense reduction, if sales fall short of budget.

I'd now like to show another chart which shows the way we monitor the progress of various projects.

The project chosen to illustrate the use of this particular monitoring tool is the establishment of two new sales offices. Again the column headings are very important. The first obviously identifies the project, the second shows the original critical milestone dates for the completion of the project, the third shows our current view of when that piece of the project will be completed, and the fourth, very important, shows the reasons for slippage. This particular format is very useful if a number of different departments are involved in the same project, and each has its own completion date. When one is using some kind of a programmed project technique, this is, of course, very elementary; but for many of our projects, a programmed approach is not warranted, and we use this rather elementary critical milestone style.

You'll notice in this particular hypothetical case, that one of our sales manager candidates quit and that caused two months' slippage in the identification stage, and that slippage was reflected throughout the project. This form is used and discussed at each of our quarterly meetings, and considerable pressure can be put on the identified individual responsible for completing his part of the project.

Just a final word about staffing. If you are going to create a business plan, that requires some staff; if you are going to really monitor your progress against that business plan, it requires an even more skilled staff and careful attention by top management. Once the involved people get the idea that they can set a business plan and forget it, the value of the business plan is destroyed. Very smart, hard-nosed monitoring activities are necessary in order to get some real benefit out of the business plan. The forms that I have shown you and the techniques that we have used have proven extremely valuable in getting the job done and improving our profit potential.

MR. WILLIS B. HOWARD, JR.: One of the panelists mentioned two columns, variance from budget and variance from plan. What is the difference?

MR. GOODE: The two columns were Variance from Budget and Variance from Forecast. In our planning cycle, the budget for the ensuing year is cast in concrete each fall. As results unfold throughout the year, we make forecasts of the full year's results, typically one in the spring and one in the fall. The forecast made in the fall becomes the springboard for the following year's budget. But the forecasting process is also important in its own right to determine how the financial results are progressing.

MR. FRANK J. ALPERT: If you are making a forecast or projection, do you project on what your goal is, or on what you think is going to happen?

MR. GOODE: You have to set a plan based on goals that are agreed to between you and your boss. That goes for all levels of management. The manager who can convince his boss that his goal is what he damn well knows he can do, is the lucky manager indeed. What he needs is a new boss.

MR. ALPERT: Do you make a forecast of financial results based on a sales goal?

MR. GOODE: Realistically, you have to apply a discount to what the sales people say they will do in the process of setting very high, stretch goals for themselves.

MR. GARY B. CORBETT: To what extent does your business plan or budget deal with unit costs as opposed to pure dollars?

MR. WAUGH: We do not use unit costs when we are drawing the budget up. After we have done the budget, we look at the unit costs to see if they are reasonable. If they are not, it may result in a review.

MR. GOODE: The only place we really use the unit costs effectively in the budgeting and planning process is in acquisition expenses. In the home office, we use it only in a peripheral way.

MR. COLLINS: Productivity is becoming a very crucial issue for us; if we don't control productivity, our businesses will be in trouble. Can unit costs be used in long range planning and in setting specific goals for managers? Can they be used to translate corporate objectives in terms of financial results into specific objectives for the managers in the company.

MR. HENRY W. SIEGEL: In our group health claims area, we have set up some unit cost bases that we will be using in our budgeting procedures for the first time this year. We will be setting an objective based on a certain number of payments, and certain costs per claim. We will probably hold the area to the cost per claim rather than to a fixed amount of dollars. If the volume of claims goes up or down, they will have to manage their expenses the same way.

MR. ROYAL A. JOHNSON: I wouldn't go so far as to call it unit cost at this point, but we do have an incentive program for five managers who report to me in the Agency Managers Marketing Division. In each of their incentive plans is one component which addresses itself to the expenses controlled; we measure the dollar spent against either sales, premiums, or premium growth, depending on the manager's primary function.

MR. CHARLES C. MCLEOD: I am interested in one of Mr. Goode's reports that showed the quarterly gain from operations. How useful is the comparison of actual and forecast investment income? For instance, if you have more business than you expect to write, premiums will go up, the increase in reserves will go up, and investment income will be affected. Due to the interdependence of items, investment income is different from forecast, but that doesn't necessarily mean that the investment department is doing a good or a bad job.

I would have thought it would be more useful to look at the gain or loss from various sources, for instance, the loss resulting from actual expenses being greater than those assumed in the premium rates. Then you have a better idea why total actual earnings differ from total forecasted earnings.

MR. GOODE: There are backup exhibits pertaining to, say, the investment income by itself. Certain key lines of the exhibit are supported by other exhibits, so they are not just freestanding. The manager of the investment department has his own exhibit. A variance in cash flow which is not under his control would be identified and would cause a change in result, which would then bleed over into the net income exhibit.

It is important that the manager of an enterprise not be relieved of bottom line responsibility because of what happened in his investment department. For, say, the individual life business, the elements shown are premiums, claims, expenses, investment income, and variations therein. Virtually all of those are under his control. The one that needs further analysis is the investment income.

MR. ANGLE: This discussion would also imply that the reports are not necessarily self-explanatory. That is essentially why you have a quarterly review meeting, in which the manager has to say what went wrong. It may be a whole sequence of things. This, I take it, is the sort of stimulus that may trigger what Mr. Waugh called an exception or demand report?

MR. WAUGH: Yes, when a particular item of expense is under consideration, we can produce from the system all the items that have generated that particular expense. The requests normally arise outside the budget area; the budget area generates the reports to answer the questions.

The budget area monitors the reports. They look at variances and ask for an explanation, routing the request up through divisional vice presidents. So, effectively, we think the divisional vice president has a responsibility, with the budget area doing the identification. The request for additional information arises when these variances go out, and people don't see how the figures in question were arrived at.

MR. GOODE: Do you have certain criteria that would trigger one of these requests for justification of a variance?

MR. WAUGH: We have some sort of a general guideline, but it is primarily the budget manager who reviews the figures and concludes from his past experience what variance is significant. He is reviewing them on behalf of the divisional vice president. It is the responsibility of the divisional vice president, not the budget department, to take corrective action to bring the variances back into line.

MR. JOHN BURKE: I would like to ask Mr. Waugh just what expenses are reported. Do they include any allocated overhead, or is there a big expense pool? For instance, can a manager rationalize an expense overrun simply by saying that he was allocated too much of the president's salary?

MR. WAUGH: Each individual has responsibility for the expenses that he has control over. Some expenses are controlled only at the divisional vice president level. A manager wouldn't see the amount of the president's salary allocated to his department because he is looking at actual expenses as they occurred. The president's salary is sitting somewhere else, and is allocated later when we do the functional costs.

MR. GOODE: We do it very differently. That piece of the president's salary is in there, although the president's salary is a bad example. Let's discuss the personnel or law department instead. If, for instance, the sales manager tries to explain away an expense overrun by saying that the law department allocated too much expense to him, he is asked whether he went to the law department to negotiate those expenses. Typically, he never went to the law department to discuss the matter.

MR. ANGLE: The dynamics of this are interesting. We are discovering that people in our profit centers are suddenly very interested in what the charge per hour of CPU (central processing unit) time is, why computer cost is allocated in proportion to CPU time, etc. They suddenly realize that there are resources involved which they will have to answer for. We are far from the stage of perfection at conducting the negotiations, but we think that it is important that they take place.

MR. SYED A. ALI: Mr. Goode mentioned earlier that the profits forecast from a five year business plan prepared five years ago should be compared to the actual results achieved, and the manager should be held responsible for any large differences. At my company, Occidental Life, we have a five year business plan, and we tried to compare the results. I must admit that we ran into problems. The difference in results was very large, and there was not any one particular reason which could account for this difference. Let us take the example of expenses. In 1972, no one expected double-digit inflation in 1974-75, and, consequently, our 1976 expenses estimated in 1972 were substantially different from the actual expenses. Do we hold the manager responsible in such a case? Again, in 1972, no one had expected the severe recession of 1974-75, and, consequently, our five year sales projection was completely out of line with the actual sales. These examples are only a couple of the many variations possible in which it is difficult to hold the manager responsible for not meeting a forecast of five years ago. Another problem is that the manager of five years ago may not be around to explain. In light of all this, what should we do?

MR. GOODE: The organization must be reasonably static. If you reorganize your company, it is almost impossible to hold a manager accountable for what he said he would do three years ago. But there are some key indicators that can be monitored, like lapse rates, unit costs, and expenses and life insurance sales adjusted for inflation. You don't get nice, precise answers, but if the organization has been static, you can get a reasonably good fix on the manager's performance.

Mr. COLLINS: I think that was a good example of the difference between long and short range planning. We do it very formally and very seriously. We work hard and try to come up with the best five year plan that we can, but we know one thing for sure: five years from now, when we look back, things won't have happened the way we thought they would five years ago. We are going to have to make a few detours along the way. That is why I describe the five year plan as a "roadmap".

We can really zero in on specific expense goals in setting the one year plan. But we will probably have to modify expense goals four years out before making the one year plan for that year. There are important differences in how you assign accountabilities in long range and short range planning.

MR. CLAUDE THAU: Mr. Goode's comment that we sometimes don't monitor ourselves sufficiently in the home office seems to be true of the actuaries that I have seen. There is always some excuse: you had some new projects that you didn't anticipate, you had staff rotated into your area that are higher salaried than you budgeted for, or people pass exams that you didn't expect them to pass. From my experience as a manager in actuarial, it never seemed that anyone was looking at my results compared to budget. The only thing I have seen today that might help actuarial develop better management and cost effectiveness is the time study chart presented by Mr. Goode. It seems that in many areas, we need project budgets, not annual budgets. We could get some quicker feedback that way, too.

MR. ANGLE: That is true. We can borrow some techniques from data processing. You have to distinguish between maintenance activities and project related activities. For project related activities, you should estimate, have the resources required, set up milestones, and report. Certainly any actuary in a managerial position should be judged on some of the criteria that Bob Goode was talking about. Peter Drucker had a marvelous short essay in the Wall Street Journal some months ago. He said that to evaluate company presidents and senior managers, you should look at their performance: their planning performance, their performance in the use of corporate resources, and their performance in the development of people. These are three pretty good criteria that could apply to our chief actuaries as well.

MR. CORBETT: Is the best way to control cost in budgets by responsibility or by functional cost? One example is data processing ("EDP") charges. Should they be controlled directly as EDP charges, or should they first be allocated to new business, policyowner service, etc., so that the managers of these departments are responsible for the costs allocated to them? I have a bias here in favor of the latter method, because, if you change systems, you can really be fooled as you transfer more clerical operations into EDP.

MR. COLLINS: The only way to really control costs on a month to month basis is to get them reported properly to the man who can do something about them, and hold him accountable for them. But unit costs can be used too, perhaps not on a month to month basis, but in terms of evaluating costs and planning ahead.