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EVOLUTION OF ACCOUNTING STANDARDS AND CURRENT DEVELOPMENTS

Moderator: HENRY B. RAMSEY JR. Panelists: JARVIS FARLEY, ALBERT A. KOCH**, RICHARD S. ROBERTSON, REED K. STOREY****

MR. HENRY B. RAMSEY: We will begin with a presentation from a representative of the Financial Accounting Standards Board and will then hear comments from the other three members of the panel. Dr. Storey was the accounting research division director of the American Institute of Certified Public Accountants (AICPA) during the 8 years preceding the establishment of the Financial Accounting Standards Board (FASB). He was named the first academic fellow by the FASB and is the senior staff man assigned to the conceptual framework project.

THE FASB'S EFFORT TO ESTABLISH A "CONSTITUTION" FOR FINANCIAL ACCOUNTING AND REPORTING

DR. REED K. STOREY: The conceptual framework project of the FASB is a continuing effort involving several phases or steps expected to be accomplished over several years.

To better understand the context in which this work is going forward, let us start with some background. Fifty years ago, there were no accounting standards. Each company used its own methods and reported whatever appeared to it to be appropriate. Then, around the beginning of the Great Depression, about 1929 or 1930, the Institute formed its first committee to be concerned with accounting principles. In 1938, the Committee on Accounting Procedures was formed. This Committee issued 51 Accounting Research Bulletins across the following years, but became the subject of criticism for its practice of tolerating varying solutions to questions of accounting practice. The year 1959 saw the founding of the Accounting Principles Board (APB), whose watchword was research into the basic principles of the profession. However, once again there was criticism: Accounting Research Studies 1 and 3, for example, were not well received.

In 1973, the APB was replaced by the FASB. Where the APB was a committee within the AICPA, the FASB has seven supporting organizations. The procedures of the FASB have been formalized. First, discussion documents are issued, leading to hearings. Subsequent deliberations lead to an exposure draft of conclusions. After consideration of comments received, the FASB finally issues a Statement of Accounting Standards. To date, sixteen Statements have been issued.

*Mr. Farley, not a member of the Society, is a Fellow of the Casualty Actuarial Society and is currently Chairman of the Board of Babson College.

**Mr. Koch, not a member of the Society, is a partner of the accounting firm of Ernst and Ernst.

***Dr. Storey, not a member of the Society, is Assistant Director, Research and Technical Activities Division, of the Financial Accounting Standards Board. The Financial Accounting Standards Board, as a matter of policy, disclaims responsibility for any statement of its individual members or staff. Accordingly, the views expressed are those of the speaker and do not necessarily reflect the views of the Financial Accounting Standards Board.

The conceptual framework project has proceeded a little differently. The work is expected to proceed through several stages. The first stage involved the work of the Trueblood Committee which ended in a hearing in 1974. We are now in the second step or phase. Three documents issued December 2, 1976 are the basis for that phase and relate to both the first and third phases.

1. Tentative Conclusions on Objectives of Financial Statements of Business Enterprises is what its name says and follows from the first step in the project, a Discussion Memorandum (June, 1974) and public hearing (September, 1974) on objectives, based on the Report of the Study Group on the Objectives of Financial Statements (Trueblood Committee), which was published by the AICPA in late 1973.

2. The Discussion Memorandum, "Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement," is a major effort in the second phase and leads into a third phase on measurement. In this Memorandum, the Board set forth issues as it saw them and asked for comment. In all, nine issues were set forth.

   Part 1 is concerned with defining the elements of financial statements--assets, liabilities, owner's equity or capital, earnings, revenues, expenses, gains, and losses. Part 2 is concerned with qualitative criteria, while Part 3 deals with selecting the attributes of those elements that should be measured and reported in financial statements to meet the objectives and enhance the qualitative characteristics of the information. Some attributes raise the issue of maintenance of financial capital versus maintenance of physical capital. At this stage, the Board hopes to be able to decide which of the attributes (historical cost/historical proceeds, current cost/current proceeds, current exit value in orderly liquidation, expected value in due course of business, and present value of expected cash flows) are worth considering further and expects another step before a decision is made on measurement. All these methods are currently used; however, except for historical cost, their use is limited.

3. The booklet, Scope and Implications of the Conceptual Framework Project, contains a brief summary of the other two documents and gives some preliminary thinking about various possible courses leading from the beginning steps of the project. Since this is a summary, it tends to oversimplify.

Some Questions and Answers About the Conceptual Framework

A. What is a conceptual framework?

   The reference to "constitution" in "Scope and Implications..." is a pretty good place to start. A conceptual framework is a "constitution," a coherent system of interrelated objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function, and limits of financial accounting and financial statements. The objectives identify the goals and purposes of accounting. The fundamentals are the underlying concepts of accounting, concepts that guide the selection of events to be accounted for, the measurement of those events, and the means of summarizing and communicating them to interested parties. Concepts of this type are fundamental in the sense that other concepts flow from them and repeated reference to them will be necessary in establishing, interpreting, and applying accounting and reporting standards.

The FASB project will have at least six steps:

1. Objectives.

2. Definitions of elements (earnings, assets, liabilities, capital, revenues, expenses, gains, and losses)--we already have general definitions of these elements, of course, but the definitions have proved not precise enough to help solve many problems.

3. Qualitative characteristics (relevance, reliability, comparability, understandability, timeliness, and the like); matters of priority, weighting, tradeoffs, etc.

4. Attributes to be measured.

5. Recognition (executory contracts, revenue "realization," expense recognition, allocation, etc.).

6. Financial statement form and content.

Step 1 was the subject of the "Tentative Conclusions..." publication while Steps 2 and 3 were covered in the Discussion Memorandum. While Step 6 logically should be last, there is, understandably, great interest in this subject, and some of the limited staff currently available has been allocated to this step, while Step 5 remains unstaffed.

B. What is a conceptual framework supposed to do?

Accounting is a growing profession -- barely 100 years old in the United States and less than 150 years old in the United Kingdom. Historically it developed pragmatically--accountants solved problems as they arose. What principles we had were derived from practice. This worked well as long as matters did not get too complex or conditions did not change too fast.

This ad hoc way of solving problems has, however, tended to break down, and accounting and accountants have been criticized with increasing frequency:

Solutions developed for similar situations have often been different and even inconsistent.

Too many alternative accounting methods have become accepted for accounting for the same thing (perhaps the feature that has caused the most criticism); in some cases these methods contradict one another.

Methods have been abused, and "loopholes" in them have been plugged with rules, which are followed by more rules to plug "loopholes" in the first rules, etc.

> Inability to reconcile very basic points of view has led to varying solutions to the same accounting problems without an adequate basis for selecting the best solution in the circumstances.

Financial accounting has been, and still is, going through the process of trying to find some order in the vast body of experience that it has accumulated. We are trying to isolate and describe the fundamental concepts and relationships in the extremely complex business environment with which financial accounting is primarily concerned.

These concepts and relationships are identified and analyzed primarily by careful analysis of similarities and differences between various things and events. A physician, for example, sees patients that are different in many ways: size, weight, shape, hair color, age, number of teeth, etc., but he or she treats them by largely ignoring those differences and concentrating on significant similarities--a set of symptoms that permit diagnosis and treatment of a particular disease. Similarly, to identify an asset, e.g., accountants must largely ignore the numerous differences between cash, accounts receivable, inventories, property, plant, and equipment, etc., and concentrate on the significant similarities, the most important of which is the fact that all confer future economic benefit on their holder.

Differences are also important. For example, assets and expenses are similar in many significant ways, but they are different in at least one crucial way--assets confer their benefit in the future while expenses have already conferred their benefit on an enterprise. The goal is to define concepts and describe relationships between them in a way that enables us to solve problems logically and consistently.

Perhaps another analogy would help. The great Gothic cathedrals of Europe were built during the late Middle Ages largely by a process of trial and error, and a great many towers and vaults collapsed during or shortly after construction. But from their successes and failures, the builders learned about such matters as stress, thrust, and the characteristics of structural shapes and applied these concepts and principles to develop ribbed vaults, flying buttresses, and other ingenious features. These features permitted them to build not only very high, but also very beautiful, buildings that have now stood for five to eight centuries.

This trial and error process is essentially what the accounting profession is undertaking. We are trying to infer from our successes and failures and deduce from those fundamentals we already know some generalizations and principles which can be used to solve not only existing problems, but also problems which, when they develop, will prove to have significant similarities to and differences from those with which we are now familiar.

Archimedes contemplating the principle of the lever said, "Give me where to stand, and I will move the earth."

I am not sure we are going to move the earth, but, in effect, this is what a conceptual framework should do--give us a place to stand, a set of common premises from which to reason and argue toward standards, principles, procedures, methods, etc.

Actually, our problem is not that we have no place to stand, but, rather, too many places. A good example of the point is the controversy over the problem of accounting for business combinations. One view--the purchase method--sees a business combination as the purchase of one business by another; the other--the pooling of interest method--sees it as a stock swap between stockholder groups. The first sees the combination as a transaction of the acquiring enterprise; the second does not--indeed, there is no acquiring enterprise. The purchase method records the net assets of the acquired business at their purchase price; the pooling of interest method continues all assets and liabilities at their previous carrying amounts. Usually, the pooling of interest method reports higher earnings after the combination than the purchase method. The issue was highly controversial and emotion-charged by the time the APB issued two Opinions on the subject in 1970.

In the minds of many critics, APB Opinion No. 16, "Business Combinations," and No. 17, "Intangible Assets," are the ultimate example of the worst consequences of standard setting by committee--critics often picture a committee composed of vacillating men, eager not to offend clients, giving in to pressure.

I drew, and still draw, a different conclusion from what I observed while those Opinions were being developed. The Board never worked harder to do things right--to consider the underlying theory, to prescribe accounting that described what had happened in particular business combinations, and to solve the problem once and for all. But, from the start, the Board was hopelessly divided, and an Opinion that either proscribed the pooling of interest method or applied it to all combinations effected by exchanges of stock was never in the cards. There were not just two basic views of the nature of business combinations but three, four, and perhaps as many as six, seven, or eight. Some of those views could be reconciled on some points, but not on the whole. In short, there were too many different conceptual frameworks being applied.

It is easy to attribute the result to pressure. The APB was under great pressure, of course, and the SEC pulled the rug out from under the APB (on the size test) at the last moment, but these do not, in my opinion, represent the major problems. The lack of agreement on such basic questions as "What is an asset?" and "What is a transaction?" was the underlying factor; the usual explanations dealt mostly with symptoms rather than the disease.

A conceptual framework is not going to solve all of the problems of accounting, and it will not solve any of them automatically--it is not a cure-all. But with it we should be able to avoid re-inventing the wheel on every matter. Business combinations, leases, income tax allocation, pensions, and many other topics have a habit of coming back to haunt accountants every 10 years or less. They just do not stay solved by the pronouncements of the committee on accounting procedure and the APB, and the same issues tend to be argued and reargued each time around. If they were solved within the context of an established conceptual framework, they should stay solved at least a little longer.

C. Where does the conceptual framework project stand now?

The project stands in the midst of the second phase or step. A lot of work has gone before, such as the Discussion Memorandum on Objectives in 1974 and earlier work by other groups, such as APB Statement No. 4 and the report of the Study Group on Objectives of Financial Statements (Trueblood Study Group). The current phase is built on these and many other sources.

The "Tentative Conclusions on Objectives...," the Discussion Memorandum, and the "Scope and Implications..." were issued December 2, 1976, with a public hearing scheduled for June 27, 1977. In response to many letters requesting more time to respond, the schedule was later delayed and changed to two hearings: August 1 and 2, 1977, on objectives and definitions of elements, and January 16 and 17, 1978, on capital maintenance and measurement questions.

FASB has received 295 letters (at last count) commenting on the "Tentative Conclusions..." and Discussion Memorandum, and 27 commentators participated at the August hearing (including three actuaries or actuarial organizations). More letters will be received later in the year for the January, 1978, hearing.

Responses to "Tentative Conclusions on Objectives...," have been somewhat mixed:

A few accepted the Objectives as stated, and a few rejected them completely.

Most expressed general approval but suggested changes and improvements, some so extensive that they may amount to a general rejection. Three main suggestions were offered.

1. To distinguish financial statements (narrowly defined) from a broader area often called financial reporting.
2. To recognize users of financial reports other than investors and creditors.
3. To recognize stewardship reporting more specifically as a function of financial statements.

The comments on the Discussion Memorandum have been more definitive, and certain views came through loud and clear. A vast majority of respondents wanted four things:

1. Articulated financial statements.
2. Continued measurement of earnings by matching costs and revenues.
3. Reported earnings to reflect maintenance of financial capital measured in dollars with general price level adjustments or maintenance of physical capital shown only in supplemental disclosures.

4. Historical cost to remain as a basis for financial statements with information about the impact of inflation disclosed supplementally.

A very few said accounting cannot show the impact of inflation on a business and should not try. Even fewer wanted some form of current cost or current value accounting in financial statements (i.e., not as supplementary information), but most who favor that as an ultimate solution presently favor supplemental disclosure during a period of transition. A larger number wanted to include the effect of inflation on cost of goods sold (LIFO) and depreciation (current cost depreciation) in the financial statements, but most who favored that change did so only on the condition that current cost depreciation be accepted for federal income tax purposes.

The Board is now ready to start making some specific decisions about Objectives and definitions of Elements.

D. What of the Future?

Many people have speculated publicly or in letters of comment on the course that the Board would follow in the conceptual framework project. The August hearings probably caused many to change their predictions, especially among those who attended and those whose predictions were "far out." The hearings made quite clear that the FASB is not on the verge of making sweeping, revolutionary changes in financial accounting and reporting.

I am not much given to prediciton, and I do not wish to stick my neck out to try to predict what seven independent, strong-minded men will finally agree on. However, I doubt that the conceptual framework adopted by the Board will be accurately described by such adjectives as "revolutionary." Changes from the existing framework may not be very visible except to those who have followed the project closely.

This does not mean that the Board's decisions on conceptual framework will be trivial, that they will not affect the way many enterprises account for many things, or that they will not require reconsideration of some important outstanding authoritative pronouncements. It does mean that, in the future as in the past, major changes will come relatively slowly, with lots of discussion and debate and only after much trial and experimentation.

MR. RAMSEY: Our first commentator is Dick Robertson, Vice President of Lincoln National Corp. Dick is currently chairman of the General Committee of the Academy's Financial Reporting Committees and was formerly chairman of the Life Committee. He is also a member of the Liaison Committee between actuaries and accountants. Dick was one of the three actuaries who appeared at the hearings that Reed mentioned earlier. Dick will comment from the point of view of the Academy Committee on Financial Reporting.

IMPLICATIONS OF THE "CONCEPTUAL FRAMEWORK" PROJECT WITH RESPECT TO INSURANCE COMPANIES.

MR. RICHARD S. ROBERTSON: Existing accounting standards and practices have evolved primarily in the environment of industrial concerns. Accounting for insurance companies and other financial institutions is in a sense an effort to adapt the principles developed for industrial concerns to the financial environment. This adaptation has worked fairly well and most of us are reasonably satisfied with the accounting model which now exists for life insurance companies. This is not to say that our accounting model is without problems.

While the accounting profession is re-examining its fundamentals, we have an opportunity to begin again with the fundamentals in developing the life insurance company and pension plan accounting model. This is an opportunity we should welcome. We may hope that the result will be a framework which will work equally well for industrial and financial concerns and which will not burden insurance companies with rules designed for non-financial entities.

Many people in the insurance business question whether it is appropriate to apply the same accounting framework to industrial companies and financial institutions such as insurance companies. After all, the nature and purpose of the organizations are significantly different. In my opinion, this may be a valid observation for mutual life insurance companies and pension plans. However, stock life insurance companies compete for investor funds with all other investor-owned companies. Investors have a strong legitimate need for a reasonably consistent basis of comparison between life insurance companies and alternative investments.

The Tentative Conclusions part of the Conceptual Framework identifies the needs of investors and creditors as the primary objective of financial reporting. This would certainly require as a corollary that stock life insurance companies be subject to the same standards as other investor-owned companies. It does leave open the question as to whether the same standards should be applicable to mutual life insurance companies and to other entities with which we actuaries are concerned and which are not investor-owned, such as pension plans and other welfare funds.

Of the several issues identified in the Conceptual Framework Discussion Memorandum I intend to examine three and consider the impact they might have on life insurance company accounting.

The first issue identified in the Discussion Memorandum involves a point of reference. Existing accounting practice begins by defining earnings in terms of revenues less expenses, with expenses allocated between accounting periods so as to most reasonably match costs with revenues. Assets and liabilities are defined so as to be consistent with this view of earnings. An alternative approach would emphasize definitions of assets and liabilities, with the difference representing the net worth of the organization. Earnings would then be defined as the change in net worth.

Statutory life insurance accounting is based on the asset and liability approach. The gain from operations is essentially based on changes in assets and liabilities, although some changes are taken directly into the surplus account. Pension accounting is also essentially based on the asset/liability approach.

Even life insurance GAAP accounting might be thought to be based chiefly on the asset/liability approach. The major liabilities--policy reserves and claim reserves--are valued at the end of each accounting period and the difference is an element in the income statement. For most companies, the deferred acquisition cost is calculated on a valuation basis. And, of course, most of the invested assets are calculated as they would be if the asset/liability approach were adopted.

Life insurance accounting appears to lend itself to the asset/liability approach rather than the revenue/expense approach. Even if GAAP principles call for the revenue/expense approach, as now, life insurance accounting would represent primarily an adaptation of the asset/liability approach to produce results consistent with those produced for other companies. Hence, the resolution of this issue will probably not have much effect on life insurance accounting except to the extent that it influences how some of the other issues are decided.

The second major issue, although not articulated as such in the Discussion Memorandum, concerns the historical cost and current value methods: should accounting continue to be based primarily on historical cost, or should some form of current value accounting be adopted? If the current value approach were taken, life insurance companies would need to revalue all assets to a current basis each accounting period and would need to recalculate all policy reserves on currently appropriate assumptions. It is difficult to say what the income statement would look like. To be meaningful, it would probably have to identify separately changes in net worth resulting from changes in valuation assumptions and changes in net worth resulting from ongoing operations.

If the current value approach were taken, there would be a question as to when the expected profit on sales of insurance policies would be recognized. It would be possible to value reserves using a gross premium valuation which would recognize the expected profits at issue of the policy. Alternatively, a net premium valuation could be used which would recognize profits as premiums are collected over the life of the policy.

A third major issue concerns the adjustment of the financial statements to reflect inflation. Several approaches are possible, including using replacement costs in valuing assets and liabilities or adjusting the dollar amounts reported in the statements to reflect the declining value of the dollar. The former approach is currently required by the SEC as a disclosure item, although life insurance companies are generally exempted because the amounts are generally immaterial. The latter approach was previously proposed by the FASB, although the proposal has since been withdrawn. In either case, it appears that the effect on life insurance accounting would not be substantial because our assets and liabilities are reasonably well balanced between those which are and are not affected by inflation.

The actuarial profession, working through the Academy, is participating in the development of this Conceptual Framework project. The Academy filed a position paper and appeared at the first round of hearings last June and expects to appear again at the second round which will be held next January. Individual insurance companies and the American Council of Life Insurance (ACLI) made presentations which, while not identical, did not exhibit major differences from one another.

MR. RAMSEY: Jarvis Farley, former Chariman and President of the Massachusetts Life and Indemnity is known to many of you as a leader in the work of establishing accounting standards for life insurance, has served as chairman of what is now the ACLI Financial Reporting Principles Committee during one of its most difficult periods--in the early stages of the Audit Guide--and has served as chairman of the General Committee of the Academy's Financial Reporting Principles Committee. He is also Vice Chairman of the Liaison Committee between actuaries and accountants and has been very instrumental in bringing together actuaries and accountants to discuss their common problems and to work together.

IMPLICATIONS OF THE "CONCEPTUAL FRAMEWORK" AS RELATED TO ACTUARIAL PRINCIPLES

MR. JARVIS FARLEY : Reed Storey has articulated the need for a conceptual framework as giving the members of a profession "a place to stand, a set of common premises from which to reason and argue toward standards, procedures, etc.," thereby enabling the members "to solve problems logically and consistently."

Every profession needs such a conceptual framework. It exists in some form in the standards to which the profession adheres, and I suppose that, whatever the form, a healthy profession will always be actively concerned to sharpen and improve its standards and the framework in which they exist. Without using those words, the actuarial profession is engaged in just such an effort.

As each profession works on its own concepts and standards there are two fundamental matters on which the members of the actuarial and accounting professions ought to agree with near unanimity. The first is that the basic standards of each profession should be set by the members of that profession, through duly selected representatives. Accounting standards should be defined by accountants, not by actuaries and not by government; and actuarial standards should be set by actuaries, not by accountants and not by government. Each profession, in defining its standards, should consult closely with those who have a proper interest in the result, but in the last analysis each should determine its own professional concepts.

The second fundamental concept is that the governing principles of the two professions must be compatible. It is not necessary that the accounting principles applicable to a given situation be completely congruent with the actuarial principles applicable to the same situation, but it is essential that the two sets of principles not be in conflict. There must be some ground in common; otherwise one professional or the other would find it necessary to express a qualified or an adverse opinion, and there would be no way in which the affairs of a client could be conducted so as to be consistent with the standards of both professions.

Actuaries and accountants are both intrinsically and necessarily concerned with insurance and pension operations, which involve the control and management of funds over long periods of time and under conditions which are significantly different from the conditions which prevail in establishments whose transactions are typically completed within a short time frame. In insurance and pension operations the timing and the amounts of future cash flows cannot be determined exactly, but must be estimated by the use of probabilities; also, cash flows at widely separated points in time must be accumulated or discounted at interest so that the cash flows may be properly related, one to another, with respect to the time value of money.

The use of probabilities and the reflection of the time value of money are the characteristic responsibilities of the actuarial profession. There is general recognition of the need for actuaries to be involved in such operations and in the financial reporting of such operations. The actuarial elements in financial statements based on such operation must satisfy actuarial principles. Any failure in that respect would represent a departure from economic reality and would result in inconsistency between the operations and the financial reporting of the operation.

It follows that each profession must consult with the other in a thorough and meaningful way when defining or improving its concepts. That consulting process has taken place in the drafting of the Audit Guide for Stock Life Insurance Companies and is now taking place in connection with the financial reporting of property and liability companies and the administration of pension plans. There may be some hard problems to resolve, either in principles or in the relationships between the professions and in the determination of their respective roles; but those problems are more likely to have viable solutions if they are addressed by serious two-way communication between the professions than if they are left to the government, or if one profession tries to solve them without sufficient regard to the valid concerns of the other. The means of communication exist. I hope and trust and am confident that they will be used.

MR. RAMSEY: Our anchor man is Mr. Albert A. Koch. Al is a partner in the national office of Ernst & Ernst and his recent work has been concentrated in the area of the conceptual framework project and the impact of inflation on accounting. He has participated in planning E&E's position papers on accounting under inflationary conditions and the conceptual framework project.

MR. ALBERT A. KOCH : The FASB conceptual framework is designed to provide universal guidance to all for-profit entities--including life insurance companies. However, as Dick Robertson has indicated, there are fundamental differences between life insurance and other industries. I will briefly look at what is supposed to be the number one issue in the conceptual framework project and relate it to the life insurance industry.

The Asset/Liability Approach versus the Revenue/Expense Approach

The FASB has identified as a major issue the question of whether an asset/liability or a revenue/expense approach is best. In publications of the FASB related to the conceptual framework project, this issue is described as being of great significance producing substantive differences in earnings measurement. In a later status report, however, the question was reduced to a question of deferred charges and deferred credits. Since this latter question seems to lack significance (except as related to deferred income taxes), the status report appears to downgrade the asset/liability versus revenue/expense question to a non-issue. If deferred income taxes is indeed the key issue, then it should be identified as such. The treatment of taxes clearly should not be the keystone of a conceptual framework.

However, if asset/liability versus revenue/expense is an issue worthy of the attention it is receiving, then it would appear that one must ascribe much more to it. The real issue then becomes one of accounting for transactions versus periodic valuation. The implications of periodic valuation for the life insurance industry would appear to be:

1. Asset/liability valuation considerations identified by Dick Robertson;

2. The need to carry bonds and other investments at current value;

3. The need to revalue policy liability assumptions periodically as well;

4. Uncertainty as to when anticipated income from policy issuance would be recognized (at the front end or over the life of the policy). Resolution of this question may depend on resolution of the deferred acquisition cost question, which will be discussed below, and on resolution of the executory contract question.

Treatment of Deferred Acquisition Costs

The FASB has argued that the asset/liability approach does not necessarily lead to use of current values, but may be compatible with the use of historical cost as well. But in this case, deferred acquisition costs would be charged to income as incurred. Interpretation Number 15 defines deferred acquisition costs as deferred charges. Hank Ramsey has suggested this was inevitable because the FASB looked to the Audit Guide. However, it is not clear that that FASB would have adopted any other position had the Audit Guide not existed.

Deferred acquisition costs and policy liabilities are part and parcel of the same item and should be treated as such, but the FASB may not agree. Accountants who are not insurance specialists have difficulty seeing why life insurance acquisition costs should be treated differently from casualty insurance acquisition costs. However, in the latter case, it is probably much more difficult to argue that deferred acquisition costs are an asset rather than an expense, since no future benefits are conferred.

If deferred acquisition costs are rejected as assets, they would be charged to income as incurred. The result then would be tantamount to statutory accounting. The statement of income would lose significance unless other current value measurements were used.

One possibility would be to front-end all income from sale of policies (i.e., recognize an executory contract asset). This would lead inevitably to periodic valuation of the balance sheet.

If policy acquisition costs do meet the test as an asset, which is difficult for me to conceive, it would simply verify the suspicion that the asset/liability versus revenue/expense question is a non-issue.

Conclusion

I believe it would be easier to solve the deferred acquisition cost issue in the existing revenue/expense framework. To assume that the issue may be favorably resolved in the asset/liability framework may be dangerous indeed. We at Ernst and Ernst and others fear that a decision for asset/liability will be the beginning of the end for transaction-based historical cost accounting. Too much is at stake to rest on the assumption that the asset/liability versus revenue/expense question will prove to be a non-issue.

COMMENTS

MR. ROBERTSON: I agree that the Board made a mistake in Interpretation Number 15. The problem is really caused by looking upon deferred acquisition costs as assets, rather than as part of the valuation process. The other comment that I have is that in life insurance, under both statutory and GAAP accounting, we have an example of an asset/liability approach based on historical cost, and it has worked out very well.

We would hope that it is not necessarily true that the asset/liability approach would lead either toward immediate recognition of deferred acquisition costs or toward current value accounting.

MR. HENRY B. RAMSEY: It is important to recognize that the definitions of asset and liability in the Discussion Memorandum contemplate a future oriented valuation. It is this orientation toward the future as distinct from the accountants' traditional concern with the past that has caused the abrasive confrontation. Once it is recognized that the only true economic result must include a valuation of futures with regard to assets and liabilities, and that this is an important part of financial statements in total, then I believe the conflict will be resolved.

MR. CHARLES WALLS: Most people would not want to be taxed on the asset/liability basis, but would prefer to be taxed on the revenue/expense method.

MR. DONALD GRUBBS: Our profession has followed the same practices as the accounting profession in the sense that each actuary has been allowed to go his own way. Some have suggested that actuaries set up an FASB of their own. Is an actuarial FASB indicated? Would such a body better relate to the accounting FASB?

MR. FARLEY: The usefulness of such a body would depend on its degree of acceptance and credibility. We have had bodies of principles throughout our history. The need for standards arises because of a need for public visibility, and accountability standards give rise to visibility.

Currently, the structure of the actuarial profession is undergoing reexamination. Much of this reexamination is concerned with questions of standards. This is part of an evolutionary process which has worked reasonably well. I do not think it necessary to set up a special Actuarial Standards Board independent of the committees of the several actuarial organizations.