The Actuary
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## EXCELLENCE

*by Deborah Adler Poppel, Associate Editor*

I just read a book that both excited and embarrassed me. From that description you'd think it was a Harold Robbins novel, but instead it was a rather dry management text—*In Search of Excellence—Lessons from America's Best Run Companies.* The authors, management consultants Thomas J. Peters and Robert H. Waterman Jr., studied America's best-run companies (based on bottom-line performance) and distilled the eight qualities they had in common.

Why would this excite and embarrass me? Because the eight qualities are wonderfully simple and achievable, and yet insurance companies in general and actuaries in particular don't achieve them.

For example, one quality is "a bias for action"—the willingness to experiment and take risks. The obverse of this trait is the tendency to over-analyze, scrutinize, committee-ize and write a voluminous report before any action is taken. Of course you shouldn't dive in to a huge risk head first, but sometimes it's cheaper, quicker, and more enlightening to dip a toe than to delve into every possible consequence of getting wet. Actuaries aren't the only culprits here, but I often get the sense that we don't feel we've earned our pay unless we regularly practice all the techniques of the first five exams.

Another watchcry is "productivity through people"—the art of treating people as adults and partners, with dignity and respect. How often do we couch our ideas in jargon rather than translate them into English, with the excuse that "it's too complicated for a non-actuary to understand"? Are we afraid that if we make our jobs more understandable, then we won't seem so smart?

Of course, actuaries aren't alone in this crime; doctors and lawyers also hide be-

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## THANKS & GREETINGS

Michael B. McGuinness of Toronto, an Associate Editor ever since April 1979, has left our Editorial Board to become the Society's new Treasurer. We are grateful for his faithful labors and always cheerful help.

Canada's new Editorial Board member is David S. Williams, who has been serving this newsletter effectively as a reporter. A steady flow of Canadian actuarial news is assured.

## NON-ROUTINE BUSINESS OF BOARD OF GOVERNORS AND EXECUTIVE COMMITTEE, JULY TO OCTOBER 1983

*by Kenneth T. Clark, 1980-83 Secretary*

1. Discussions with the American Society of Pension Actuaries of future use by ASPA of our examinations in qualification for the FSPA designation are under way. The Executive Committee has approved this idea in principle.

2. The Board has approved certain refinements in the Society's investment policy, and appointment of Ernst & Whinney as our new auditor.

3. To streamline our elections procedure, the Board has amended Article V of the Society By-Laws.

4. A favorable report on the Society's compliance with United States anti-trust laws has been received from the firm of Paul, Weiss, Rifkind, Wharton & Garrison.

5. The Board discharged the Committee on Futurism, its functions having been assumed by the Futurism Section.

6. The Society is now a full member of the Committee of Presidents of Statistical Societies (COPSS).

7. The Board received and approved the final report of the Task Force on Smoker/Non-Smoker Mortality.

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## DO MUTUAL LIFE COMPANY STATEMENTS CONFORM TO GAAP

*by Daniel F. Case*

The financial statements of most or all mutual life insurance companies are presented as being in conformity with GAAP, but the standard for judging that conformity has not been established. What should that standard be?

The natural suggestion is that to judge the conformity, the accounting rules applied should be the same as those applied to a stock life company. The assets (bonds, mortgages, etc.) should be valued by the same rules, and the obligations (guaranteed death and annuity benefits, etc.) should be valued by the same rules. But various objections to this straightforward approach have been raised. Let us examine these.

*Objection #1:* A mutual company has no stockholders.

*Answer:* Let us call the excess of assets over obligations the "net worth". A stock company's net worth is the amount of money available, subject to future financial results, for future distribution as stockholders' dividends. A mutual company's net worth is the amount available for future distribution to policyowners as policy dividends. This amount will not be comparable to a stock company's net worth if the assets and obligations are measured by rules different from those for the stock company.

*Objection #2:* Future dividends to mutual company policyowners must somehow be recognized, but they are not "benefits".

*Answer:* Future dividends to stockholders, not already declared, are ignored in a stock company's statutory and GAAP balance sheets. Future dividends to policyowners, not already declared, are ignored in a mutual company's statutory balance sheet; they should, likewise, be ignored in a mutual company's GAAP balance sheet.

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## GAAP

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It is important not to try to apply to a mutual company the rules for a stock company's participating business. A stock company's participating business has no parallel in a mutual company. The stock company must allocate its net worth between its stockholders and its participating policyowners. By contrast, in a stock company that has only nonparticipating business the entire net worth is available for future distribution to stockholders, just as a mutual company's entire net worth is available for future distribution to participating policyowners. Accordingly, the accounting rules to use for mutual company GAAP are those used for the nonparticipating business of stock companies.

*Objection #3:* Mutual companies have no "earnings" comparable to those of stock companies.

*Answer:* Mutual company financial reports need not show an "earnings" figure. Statutory statements, however, do show net worth and change in net worth. If these amounts differ materially from the net worth and change in net worth determined by GAAP accounting rules, the mutual company's report is not comparable with the GAAP reports of other kinds of enterprises.

Some observers, noting that a mutual company has zero "earnings" over its lifetime, conclude that the company can be regarded as having zero "earnings" in each reporting period, and therefore suggest that its GAAP balance sheet show a zero net worth. Such a balance sheet would, in effect, tell the reader that the company was holding the amount of money that management considered appropriate. But this would be tantamount to showing the assets alone, hence is inappropriate for use in financial reporting.

*Objection #4:* Mutual life companies have an obligation to try to furnish insurance at cost to identifiable blocks of policyowners.

*Answer:* Some observers have argued that a mutual company, in order to be confident that it can furnish insurance at cost, needs to keep a conservative level of funds on hand, and that the total amount needed at any time may reasonably be about equal to the statutory reserve. Hence, the argument goes, the GAAP reserve might well be about equal to the statutory reserve.

But this argument confuses the form and content of a report with the accounting rules to be followed. It is possible to prepare a balance sheet that would help show how successfully a mutual company is furnishing insurance at cost; such a balance sheet would show the "net worth" of each of a number of blocks of policies. During the course of each block's lifetime, the amount of net worth shown for it as time progresses would give a measure of the company's progress toward running that block off the books (upon maturity or expiry of the last policy) in neither a surplus nor a deficit position, and, hence, toward furnishing insurance at cost to that block.

Such a report would, of course, necessitate allocating income and expense to the individual blocks. The net worth of each block could be shown on a statutory, a GAAP, or any other basis, depending on the accounting rules used. Similarly, a balance sheet showing only an aggregate net worth, as is the practice today, can be prepared on a statutory, a GAAP, or any other basis by using the appropriate accounting rules.

### *Conclusion*

All this leads me to conclude that the standard to be applied in determining whether a mutual life company's financial report is in conformity with GAAP is the GAAP standard for the nonparticipating business of stock life companies. If there are objections other than the above four, they should be brought forward and discussed. I am not suggesting that mutual companies necessarily ought to prepare GAAP statements, but only that a standard is needed for determining whether or not their statutory statements conform to GAAP. □

## Excellence

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hind jargon. A difference is that the public has an accurate sense of *what* doctors and lawyers do, even if it doesn't understand *how* they do it. As for actuaries, the public doesn't even understand *what* they do. We (as a group) seem to revel in this fact. As hard as the Society office tries to educate the public, many of us delight in the arcane nature of our profession. For example, the Academy newsletter has been publishing definitions of "actuary" from various sources, including "average citizens". Why can't we tell people what we are rather than chortle at their ignorance? And how about "Sightings"—does the AMA Journal publish references to the word "doctor"?

The third quality that I'll cite is being "close to the customer", and, as a corollary, close to the sales force. Many of these well-run companies' primary motivation is to provide a quality product with quality service, and the whole operation is geared to help the sales force do this. These companies have discovered that the financial results then take care of themselves.

Unfortunately, we often think of our agents as an obstacle to productivity. And our response to consumer needs has traditionally been slow, although, in all fairness, it's improving lately.

The five other qualities in the book elicited similar but not as heated responses from me.

I welcome both positive and negative responses to this. As I said, this embarrasses me, and I'd love for someone to explain why I'm wrong. I'm just worried that our peculiarly actuarial behavio: means that our own (and our industry's) Search for Excellence will come up empty.

## Non-Routine Business

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8. The Board has approved new Guides to Professional Conduct replacing our present Guides and Opinions.

9. The Board approved a policy on continuing education developed by the Services to Members Policy Committee.

10. The Board received and approved a report from its Committee on Planning exploring major present issues before the Society. The Board decided not to pursue seeking accreditation for Society Fellows to sign annual statements.

*Ed. Note: In closing this, his swan song, at our Annual Meeting, Mr. Clark paid graceful tribute to the Society's staff, particularly Catherine (Kathy) Keller, for their help during his term of office. "The Society's affairs," said he, "have becom so large and complex that, without o. competent and dedicated staff, the job of a volunteer Secretary would be impossible."* □