

DIGEST OF SMALLER COMPANY FORUM

INTERIM STATEMENTS

A. What procedures can be followed to produce reasonably reliable profit and loss statements during the year?

MR. H. C. DUNKLEY pointed out that, in a smaller company, trends in earnings are likely to be obscured by uneven distribution of premium income or by unusual expenses. Monthly statements are prepared in his Company, and he described in some detail the methods used to obtain reliable figures for nonledger asset and liability items. He pointed out that a preparation of accurate figures for these items on a monthly basis greatly simplifies and eases the work in obtaining the financial statement at the end of the year.

MR. A. E. ARCHIBALD stated that his Company has used interim monthly statements for a good many years. At the end of each month they have a one-page statement comparing figures for this year with last year's, in both cases on a year-to-date basis. The final figure on the statement is the change in surplus, and this is preceded by changes from assets, sales and adjustments, which vary markedly from month to month. Above that group are surplus changes of the type which are erratic from month to month, such as gains from disability, double indemnity and mortality fluctuations. Immediately above that is an analysis of earnings for the period on the assumption of average mortality, and with the erratic items already eliminated. These year-to-date earnings show a remarkably stable increase from month to month. The detailed items show income and charges, all policy charges—death claims, reserve increases and surrender values—being lumped together in one figure.

For this purpose, the method in obtaining the monthly reserve is important. He believed that his Company's method of obtaining the monthly reserve is accurate. On the main policy reserve, they start off with the net reserve at the previous December 31 (net reserve being the mean reserve less the net deferred and uncollected premiums). The reserve increase is then carried forward month by month in such a way that it does not distort monthly released earnings.

He quoted a statement from a recent article in the *Harvard Business Review*, in which the idea was expressed that reports on last month's business are most useful and effective only when they are available very early in the month, say by the second or fourth day.

MR. J. W. HAHN described in some detail the method used by his Company in obtaining interim profit and loss statements, which are prepared quarterly and consist of a balance sheet and a revenue statement broken by line of business.

Accrued and prepaid interest on policy loans is readily available from punched card files. Accrued interest on mortgage loans is calculated precisely for the very small number of loans payable other than monthly and on the basis of an average monthly due date for monthly loans, the average due date being recalculated at each year end. Accrued interest on bonds is calculated so as to give an even distribution of yield among the four quarters, and one-quarter of the annual amortization (adjusted for purchases and sales) is used for each quarterly statement.

Due and deferred and prepaid premiums on regular ordinary business are obtained from punched card files.

Life reserves are carried on a seriatim basis, and since the reserves at the end of the current and following year are tabulated at the year end by calendar quarter in which the policy anniversary falls, an exact reserve can be determined for each quarterly statement.

MR. H. M. SARASON offered a number of hints which would be useful in preparing interim statements. He stated that it often pays to prepare both a profit and loss statement and a balance sheet. He pointed out that items such as due and accrued interest on bonds may be calculated as a balancing item by estimating interest earned from the average bond yield, or obtained by inventory.

For policy reserve estimates, his personal preference is to use the gain and loss method, the reasons being that the reserve needed is the reserve which will distribute tabular interest and mortality as though business were evenly distributed throughout the year, that estimates of uncollected deferred and short-time advance premiums have little effect upon surplus when identical premium items are used in the balance sheet and in estimating reserves, and that the gain and loss method is less work. He pointed out that the effect of an uneven distribution of policy issue dates makes it necessary to adjust inventories of mean reserves for interim statements, and he described what appeared to him to be the fundamentals of adjusting the inventory method. He suggested that a semiannual inventory of reserves with monthly gain and loss estimates seems to have practical possibilities.

The task of estimating the amount of funds to be apportioned for group dividends or for group experience rating refunds for interim statements should not be underestimated.

Interim statements should be comparative statements, and should be

accompanied by explanations which tell almost the whole story without having to look at the statement proper. He suggested that work sheets for underlying data, designed for ease in use as well as for ease in preparation, should be prepared with strict accounting formality and bound or filed for future reference.

He concluded with a bibliography of references to the subject, in American actuarial literature: *RAIA* XIV, 68, Howell; *TASA* XXX, 346, C. O. Shepherd; *TASA* XXXI, 105, Gill; *TASA* IX, 262, Strong; *TASA* XXXII, 196, Papps; *RAIA* VIII, 26, Curjel; *RAIA* XIX, 272, Elston. Mr. Sarason referred to a punch card method described in *TASA* XXXVI, 87, as well as some miscellaneous comments on the subject of interim statements in the *Proceedings* of the Life Office Management Association for 1928, page 108.

MR. E. H. NEUSCHWANDER said that an interim statement, to be of practical value, should reflect a reasonably accurate picture of company progress; be in brief, concise and understandable form; and tie in closely with the annual statement. He suggested that the interim statement, broken down as between first year business, renewal business and investment, would give good results.

He pointed out that a loss on first year business and a profit on renewal business is to be anticipated. When the indicated rate of loss on first year business is viewed as an investment and the indicated rate of profit on renewal business is viewed as a return on a previous investment, it is a simple matter to relate these two items and the persistency rates on renewal business, and determine the rate of amortization of the investment in new business.

He pointed out that various factors tend to upset the even flow of profit or loss in a small company, and suggested that, since amounts of profit and loss before death claims and nonrecurrent expense should tend to be reasonably consistent for one period as compared with another, these items can best be handled by showing them as a deduction followed by final profit or loss figures. He also pointed out that an uneven distribution of business may require some empirical adjustments to the reserve, and referred to the discussion by Mr. Sharp in *TASA* XXIX for some ideas along these lines. In conclusion, he suggested that the actuary preparing an interim statement would do well to keep in mind the motto of the Society: "The work of science is to substitute facts for appearances and demonstrations for impressions."