

PROCEDURE IN THE EXAMINATION OF CASUALTY  
COMPANIES BY INSURANCE DEPARTMENTS

BY

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Before describing the routine of examination of the companies, it is pertinent to review briefly the genesis of state supervision of insurance corporations by insurance departments. The general requirements laid down by law antedate the business of casualty insurance. In fact, the most important of these laws in some states antedate the formation of insurance departments.

In the commonwealth of Massachusetts, one of the earliest acts was a resolve of 1807 by which insurance companies were required to render an account of their affairs to the next general court. By an act of 1818 all insurance companies thereafter incorporated were required to publish annually certain details of their business, and whenever so directed, to make statements of their affairs to the legislature, and submit to examination under oath concerning such statements. An act of 1827 required foreign companies to deposit copies of their charters and of the powers of attorney furnished their agents with the treasurer of the commonwealth, and to make reports and publications similar to those required of domestic companies. An act of 1836 authorized insurance companies to invest their funds in certain stocks. Therefore, the act of March 31, 1855 establishing an insurance department laid no new requirements upon the companies, but provided for examinations by the commissioners, to ascertain if they were solvent and were conducting their business according to law. One of the duties of the commissioners was to initiate legal proceedings against companies whose operations were deemed hazardous to the public, and to report to the secretary of the commonwealth the general conduct and condition of the companies and any violations of law discovered.

In New York State the insurance department was established by an act of April 15, 1859, but prior to that time there were certain definite requirements. Under the revised statute of 1828 all moneyed corporations afterward created were required to make annual reports to the comptroller of the state "in the form

prescribed by him." Charters were obtained direct from the legislature before 1846 but the constitution then provided that companies should thereafter be organized under the general laws. In the general insurance law of 1849 the minimum amount of capital stock was prescribed as were the securities in which a company might invest, and the limitation upon investment in real estate. In 1851, deposit of securities was provided for and finally an act authorized the comptroller to make examinations of domestic companies and provided for their dissolution if their assets were found insufficient to reinsure their risks. There was a legislative provision for a form for annual reports, such reports to be open to public inspection and investigation. Tabulation of these reports for printing and their submission to the legislature were prescribed. Other state departments were organized and requirements were somewhat broadened to include that of prompt payment of all claims and judgments. The above *résumé* of legal requisites was given in a paper read before the 33rd National Convention of Insurance Officials in 1902. In that paper also is a quotation from one of the former commissioners of Massachusetts reviewing insurance from 1856 to 1876:

"The unprecedented expansion of the business, the magnitude of the interests involved, and the frequent and inevitable exposure of the people to imposition and fraud under a speculative and corrupt management, demanded:

*First:* The enactment of laws specially designed for its regulation, and for the protection of policyholders.

*Second:* An energetic and effective system of supervision and registration of all corporate institutions transacting such business within the commonwealth, which should bring under rigid scrutiny an annual exhibit of their financial status.

*Third:* The establishment of a distinct executive department charged exclusively with the execution of such laws, and with the service of supervising, examining and reporting the condition of all insurance companies authorized within the state."

Thus, almost a century ago we had practically all of the essential elements of supervision. The state having granted charters of insurance, the companies were regarded as creatures of the state which were to serve the people in a fiduciary capacity; and

the state became responsible to the people for the safe conduct of the companies' affairs. The initial requirements concerned correct accounts, first of capital and the invested assets; later, laws were made relating to liabilities, particularly deferred liabilities. The state became interested in the solvency of companies and the prompt payment of claims; and above all recognized the necessity and value of making accessible to the public the audited reports and examinations made in the course of departmental supervision. The use of companies' statements as a means of checking tax levies was essential but no more important than the necessity for correct accounting of funds collected as premiums to be paid to policyholders when claims became due. At the present time, there is nothing new in principle but there have been changes in method.

The laws of the states at present differ in defining the power conferred upon the insurance commissioner to examine companies, but in general, provision is made in most states for the inspection of books, papers and securities with the added provision of oral questioning of the company's officers and agents under oath, if necessary, by the superintendent, his deputies or other duly authorized persons. In most cases the expense of examination is borne by the companies, although in some states, notably Massachusetts, the state bears the cost except certain traveling and similar expenses. The penalty for refusal to subject to examination is generally the revocation of the company's license to do business in the state.

The National Convention of Insurance Commissioners endeavors by means of a standing committee to lessen the burden of too frequent examinations. This committee acts as a sort of clearing house on examination of companies. When an examination is desired the request is made to the company's home state or several states are invited to participate instead of the former method of having each state make a separate examination.

When a state has a large insurance department and regularly examines its domestic companies, the difficulty of too frequent examinations is avoided. The remainder of this paper will follow the practice of one such state, New York, except where that of another state is specifically mentioned.

Examinations may be ordered by the Superintendent of Insurance for many reasons. They are in addition to the routine

examinations, principally, examination on organization, changes in capital stock, transfer of capital stock to surplus and special investigations of assets or liabilities when the superintendent deems such investigation to be expedient.

In outlining the procedure of examination, this paper will follow the routine examination of a domestic stock casualty company which by statute is required once every three years.

A large part of the work of examination is the reconciliation of the items as reported by the company in the financial statement given in its annual report as of December 31st, or the intervening summaries as given in the quarterly reports. As a matter of convenience, the majority of examinations are as of the last day of the year, but in some cases intervening dates are used. The report of examination consists largely of setting forth the financial statement of the company in practically the same order as given in the blank which is required for the annual report. This statement is what is known as the convention blank, has been standardized by the Committee on Blanks of the National Convention of Insurance Commissioners and serves a most useful purpose in providing statistical reports and comparisons. The verification of each of the items of the statement with the company's books and records proves the statement which has been filed. While reports of this kind may be dull reading, it would seem that a periodical confirmation of companies' reports is of the utmost value. In New Jersey a narrative report is usually made, but this is after all a matter of set up. While that form may be more attractive and readable to policyholders, however, the financial statement is an official verified record and as such seems to be a satisfactory instrument for the determination of surplus and comparison to be used in the supervision of companies and by companies themselves for statistical purposes.

In order to avoid repetitious details, reference is made here to two papers written by Mr. Tarbell and printed in the *Proceedings* of this Society. The first, ("Casualty Insurance Accounting and the Annual Statement Blank," *Proceedings*, Vol. XV, page 141) reproduces the statement items of income, disbursement, assets and liabilities, as well as the underwriting and investment of the convention blank for stock casualty companies; and the second paper ("Exhibits and Schedules of the Casualty Annual Statement Blank," *Proceedings*, Vol. XVI, page

131) contains reproductions of the important schedules of the blank. Mr. Tarbell has thoroughly discussed each item of the blank and the schedules which supplement them. It will therefore be assumed that the general plan of financial statements and the relation of the various items therein are known and understood and comments will be confined to features which are brought out in the examiner's actual verification of the statements with the books and records of the company.

While the examiner has a distinct advantage in point of time and in having the complete operations of the company under scrutiny, there is difficulty presented by the manner in which some companies' books and records are kept. Some company offices originated from foreign ownership and bookkeeping methods had to be adapted to business in this country. Companies formerly doing one line business, experience difficulty in setting up accounts for the multiple lines. While some companies follow the ledger accounts needed for the convention blank, others have multifarious accounts which must be grouped for presentation in the report. In following through the procedure of examination, the sequence of the items in the report will be used, although in actual practice the verification of these items will progress more or less simultaneously.

After citing authority for examination by appointment number, the history of the company is given in the report, particularly, the date of organization and changes, if any, in capital stock. The charter and by-laws are examined in order to make sure that the company is first: transacting only those lines of business set forth in its original charter, or subsequent amendments thereof, and second: that the company has sufficient amount of capital stock required by statute in order to transact any and all lines of business shown on the company's books. Later, a check is made of the capital assets to find if the required amount of capital has been invested in accordance with the law.

The stockholders' list is examined in order to determine ownership and control. Transfers of stock are checked and the certification of the fiscal agent is examined. The list of the board of directors is noted particularly as to the amount of stock owned by directors and officers, and as to compliance with the legal provisions governing number of directors and state residence, and also that directors own qualifying shares as stated in the by-laws.

A trial balance is taken from the general ledger and the items are grouped to make up the financial statement in the convention blank. The trial balance not only evidences whether or not the books are in balance, but also reflects unusual items in the companies' accounts which may call for explanation.

The minutes of the board of directors are read for changes in the companies' investment or underwriting policy or management. In so far as is possible, a detailed check is made of each item of the financial statement, not only to the ledger accounts, but to the books of original entry and statistical records. It may be said here that with the increasing volume of business, and because of the multiple lines of business, each constituting a company within a company, the statistical departments of casualty companies are relied upon to a great extent to furnish and substantiate the figures of the report.

The income statement presents no particular difficulty since it reflects the increase in ledger assets over the preceding period, viz: the ledger balance at the end of the previous year when the examination is made as of December 31. The income may be analyzed as received from three sources, premiums, interest on investments and increases in book value of assets or profits received from sale of assets.

You are familiar with the anomaly presented by the blank which is presumed to show income and disbursements on a cash basis. The gross premiums, however, called for by lines of insurance are on a written basis which gives rise to agents' balances in the company's assets. This is well understood by those handling insurance companies' accounts, but might be confusing to one familiar only with commercial accounts. The gross premiums written with the deductions for cancelled, not taken policies and reinsurance are reconciled with the books and afterwards are carefully listed by lines to determine the unearned premium to be set up as a liability. Interest received is usually checked with the schedules of real estate, bonds and mortgages. Other income items such as agents' balances previously charged off are checked from the accounts.

The disbursements reflect payments to policyholders for losses from which are deducted salvage items received thereon. Investigation and claim settlement expenses are set up by lines as well as the losses and are considered part of the losses. Commissions

are also checked with premiums written by lines of insurance to determine whether or not the company is keeping within the rates of commission in the agreements covering acquisition cost. Since no credit is allowed in assets for stationery or fixtures, companies usually charge off all expenditures of this kind through disbursements. Miscellaneous items of expense are carefully scrutinized and should be checked with proper vouchers. If they appear large or unusual, they are questioned. Dividends paid during the year are checked and compared with previous years. Items of borrowed money are required to be shown gross both in income and disbursements. Such items are noted in the report.

Investment expenses are related to the type of investment. Usually only those pertaining to real estate require large outlays. The remaining items of disbursements are the adjustments in assets, whether by adjustment in book value or losses shown on sale of assets. The total amount of income over the total amount of disbursements added to the ledger assets of the previous year must agree with the total ledger assets of the year of statement.

Having verified changes in ledger assets from the preceding year by means of verifying the items of income and disbursements, each item of assets is carefully checked when possible by physical examination of the assets claimed and by determining the value from the most reliable and expert source, using the following procedure.

On the date following that which is to be the date of the examination report, the examiners visit the company's office and the cash on hand is verified by actual count. All other items included in the company's cash in office are carefully scrutinized for irregularities, no items being allowed unless the company shows actual value for each amount. At the same time a form letter is sent to all banks in which the company has accounts for verification as to cash in banks as of date of examination.

The bank statements call for information as to whether or not the cash is the absolute property of the company and is not in any way held as security for loans to company officers or others. The amount of cash on deposit is compared with the volume of business. Large deposits, particularly those without interest, are questioned.

As soon as the company to be examined has balanced its uncol-

lected premiums the examiners go over these accounts by agents in order to determine the amount which will be allowed as assets. Those under 90 days are allowed and the overdues are deducted as assets not admitted. This verification of agents' accounts is often time-consuming, particularly in some of the newly admitted or in badly managed companies where no real system has been adopted for applying agents' credits, reinsurance and return premiums. Some of these items cancel the debits and if an adequate way of handling the accounts has not been worked out, it is difficult to balance them. In some cases the examiners are compelled to build up the entire amount to be allowed as an asset.

In other companies where the volume of business is actually greater, Hollerith punch cards are used or even where adding machine tapes show the complete run of the accounts, the work is considerably shortened. The clerks have a definite number of agents' accounts which they balance and they can explain the application of credits. In such cases it is sufficient to check only the underdue items which are to be allowed as assets and test check the remaining balances.

After the cash in office and agents' balances are determined, the invested assets are checked. If the company owns real estate, it is usually acquired for home office purposes or has been taken over after a mortgage has been foreclosed. In the case of fidelity and surety companies, real estate is sometimes received as salvage on losses paid. The holding of real estate with the exception of home office or branch office properties is limited by law and must be sold within a stated time unless an extension of time has been granted by the superintendent of insurance. Each parcel is checked for compliance with this requirement.

Large holdings of real estate are given to an appraiser for valuation. Appraisal is sometimes waived if there has been no radical change in values where the property is located and a previous appraisal can be used.

Real estate mortgage loans are verified as to proper recording and insurance on buildings; and to make sure that all the necessary papers for a bona fide mortgage are in the company's possession. Appraisals are made in the case of large loans and newly made mortgages to determine whether the market value is sufficient in accordance with the statutory provision, particularly to make certain that the mortgage is a first lien on improved prop-



erty and that the value of the property is at least fifty per cent. in excess of the amount loaned thereon. The examiner also must make sure that interest is being received and note which properties, if any, are in foreclosure.

Bonds and stocks which make up the major proportion of casualty companies' assets are counted in the vaults of the company and verified with the company's schedule of securities. If the examination is as of December 31st, the quotations given in the Book of Valuations of securities owned or loaned on, which is issued annually under the auspices of the National Convention of Insurance Commissioners, are applied to the par values of the company's bonds and to the number of shares of stock in order to establish a market value. If the examination is as of some date other than the end of the year, valuations are brought down to date. If the total market value of securities is in excess of the book value, the excess is carried as a non-ledger account. Conversely, if the book value carried in the company's ledger assets is in excess of the department's market value, this excess is carried as an asset not admitted. In other words, no change is made in the company's book values whether of real estate or securities. Market values, however, are determined and the market values are used in the determination of the asset value. This puts the companies upon a uniform basis so that a comparison of companies is made possible.

While the insurance law governing investments for casualty companies is much broader than for life companies, solvency of the companies issuing being the only criterion for bonds and stocks other than those required for capital investment, there are restrictions with regard to ownership of the company's own stock, which if taken credit for must be deducted as an asset not admitted. Investment in stocks of insurance companies doing the same class of business is also limited. A recent amendment to Section 16 of the New York law prohibits the investment of more than 10 per cent. of the company's assets in securities of one institution. This does not apply to the stock of insurance corporations.

When insurance company stocks are held, instead of using market quotations, actual sales, etc., as in the case of the other securities quoted in the book of valuations, the capital stock and the company's surplus after audit or examination by the depart-

ment in relation to the number of shares outstanding is used to determine the value of a share. Care is taken to see that interest is received on bonds and that none are in default.

As a rule holdings of collateral loans are not proportionately large. All such loans are scrutinized, particularly those made and paid off during the year, first, to determine if interest has been received and that the market value of collateral securities is sufficient to cover the loan, and second, to determine whether or not loans were made to directors or officers of the company or those pecuniarily interested in the company. Such loans are in conflict with the law.

Miscellaneous assets are examined and unless the company can show intrinsic value are deducted as not admitted.

The non-ledger assets consist principally of rent, interest or dividends due and accrued and the market value of real estate or stocks and bonds over book value. These amounts are easily verified with the proper schedules. The total amount of non-ledger assets is added to the ledger assets. From this sum, assets which are not admitted, such as agents' balances overdue, furniture and fixtures, company stock, etc., are deducted.

Having determined the total assets admitted by actual physical examination and valuation as described above, the final and perhaps most difficult phase of the examination is the estimation of the company's liabilities. The largest part of the liabilities are usually the amounts due policyholders, first, the unearned premium and, second, the unpaid losses. These reserves are legal requirements.

Although the convention blank allows the fifty per cent. method in computing the unearned premium reserve, the examiner sets up as a liability the unexpired portions of the net premiums by using the month and year of issue. This method uses the mid-month instead of the mid-year for the fractions representing the expirations. The method used in the blank produces practically the same amount of reserve when the company's business is evenly distributed over the year.

The monthly expiration method is more accurate in the case of a rapidly expanding business or when business falls off at the end of the year. Where the amount in the examiner's report differs from the unearned shown in the company's annual statement, this difference is explained in the report of examination. There may

be differences also due to deductions for reinsurance premiums due from companies not admitted to do business in the state. The law forbids any allowance for reinsurance in not admitted companies, either as a credit in assets or a deduction from liabilities.

The computation of the premiums in force and the unearned thereon is a laborious one and some of the companies are now using Hollerith cards for the preparation of this item. The written premiums, cancelled and returned premiums, and the reinsurance premiums can easily be run off by month and year of issue. This method results in a saving of time both for company offices and for examiners. The liability as finally determined represents not only the amount of premiums not yet "earned" and therefore the amount returnable for each individual risk if cancelled by the company, but in toto, it is sometimes termed the "reinsurance reserve."

In estimating the liability for losses due policyholders, the problem is more complex. Indeed, with the growing volume of business and the many lines included in casualty insurance, the determination of proper estimates for losses is the most laborious and exacting feature of most examinations. Without going into too great detail as to the various methods used in arriving at the amount of this liability, some general principles may be cited.

The examiner has the advantage over the company in that the reported losses are reviewed some time after the date of statement and the date of examination. Where the actual losses are known soon after the time they are reported and are paid off promptly, the examiner uses the actual payments as the reserve. The usual practice is to have companies run off a list of the losses which were reported as of date of statement showing all payments thereon up to the time they are called for by the examiner and all company estimates as of date of statement. This is done preferably by means of the Hollerith printer-tabulator when the companies have the punch card system, or by similar lists where the printed sheets cannot be supplied.

These lists are first checked for missing claims and all claims open at the time of the previous examination must be shown as paid or legitimately closed without payment. All new claims must be accounted for. The payments made subsequent to

examination date are compared with the company's original estimate. The ratio of the amount paid to company estimates is a valuable indication in judging the adequacy of company estimates on claims still open.

The lines where losses are soon known are plate glass, burglary and theft, steam boiler and machinery. The reserves on the outstandings can soon be determined with reasonable accuracy. Accident and health claims are valued and with the exception of claims on non-cancellable policies do not present any great difficulty. In most companies the volume of non-cancellable business is not large as compared with other lines. Tabular values may be used for the reserves and from one periodical examination to another these values may be compared for adequacy.

The determination of reserves for fidelity and surety claims, workmen's compensation claims and those for the various automobile coverages, also liability other than auto, require more time, not only because these lines are written in larger volume, but because the estimate of these deferred liabilities is complicated by legal phases which differ between states and the liability may extend over a period of years before the claims are finally paid or can be marked closed.

In the case of fidelity including forgery and of surety bonds there are many small claims which may be easily determined, but there are often large contracts and other surety obligations where litigation is extensive or where the surety company is compelled to take over and complete the contract. In the estimate of liability the expense item is apt to prove material and must be estimated in addition to the liability for losses. On the other hand, salvage received on open cases must be allowed. One method is to value these cases gross as to salvage and then allow all amounts received thereon up to the close of the examination.

All claims are valued net as to reinsurance, that is, if the reinsurance is in companies admitted in the state, the amount due is deducted from the estimated loss on each claim.

The property damage and collision claims as a rule present no great difficulty. The former, naturally, are the most numerous, but can be valued by using an average value derived from the company's own experience and a comparison with the average cost per claim in companies doing a similar class of business.

The method for computing reserves for workmen's compensa-

tion insurance and for both auto and other liability is found in Schedule P of the convention blank. This method is known as the statutory reserve and is fully set forth in section 86 of the New York Insurance Law. While the reserves computed in accordance with this method form a standard of comparison, it has been found that under certain conditions the final reserves are inadequate. There is an added provision in the law which provides that where the statutory reserve appears not to be adequate, the superintendent of insurance may call for additional reserves. A committee of this Society has been working to devise a method which will produce reserves that will be more defensible and more satisfactory to the companies and to supervising authorities than the Schedule P method. In the meantime, this method is used, and individual estimates of claims must be made to make sure that the reserves set up will be adequate to take care of future losses.

The statutory method for liability losses takes into consideration the claims in suit. These claims are valued by amounts ranging from \$750. per suit for those arising on policies written during three years prior to statement to \$1,500. per suit for those policies written ten years prior.

For liability policies written during the three years prior to the date of examination the law requires that 60 per cent. of the earned premiums in each of the three years be computed and that loss and expense payments of each year be deducted from the corresponding earned premiums, the remainder for each of the two years immediately preceding examination date is the reserve for that year's business. For the third year immediately preceding examination date the reserve is the remainder or the value of the outstanding suits on policies written in that year, whichever is the greater. If, however, the total reserve for liability claims computed in accordance with the statute, as described above, is less than the reserve based upon individual estimates of outstanding liability losses, the total estimated or "case basis" reserve must be set up.

In estimates for workmen's compensation losses, the smaller claims may be averaged by using company statistics over a period of years. If such an average is used for the medical and the temporary cases, it should be computed by states, since the laws of the different states and the manner of administering the law

differ materially. In most companies the reserves are found to be ample on the smaller cases and also on the more serious cases where there is a definite maximum stated in the law. The companies are apt to be optimistic in the cases where there is a possibility of heavy losses. In New York State tabular values are required for death and total disability claims which involve life contingencies, but the latter claims for injuries sometimes do not develop immediately and are carried as temporary total disability. The change to total disability makes a considerable increase in the reserve.

In estimating claims, the expense of investigation and settlement is included and Schedule P provides both for allocated and unallocated expense. Companies differ radically in the method of allocating claim expenses to the various lines. In some cases a large proportion is allocated to the line; the unallocated portion must be prorated. When the individual claims are estimated, the expense can in some cases be determined and allocated. There is, however, the question of future unallocated. This is usually determined by using the company's own ratio for these expenses to claims over a period of years. These ratios are applied to the outstanding reserves by lines and added to the reserves. A greater effort upon the company's part to allocate expenses would have the effect of reducing the amount which must be estimated and added for future unallocated expense.

In addition to the reserves for claims known to be outstanding at the date of statement, a separate list of subsequent claims is made. These are claims which were actually incurred as of statement date but notice of which was not received until afterward. Some companies are able to estimate with fair accuracy the amount of losses which will be incurred on such claims and set up this amount as called for in the convention blank. The examiners with the advantage of subsequent developments are often compelled to increase the reserves substantially over company estimates for subsequent claims.

There is also developed a list of additional claims due to reopened and other claims which for various reasons were omitted from the company's outstanding list. This list, obviously, should not be large, since the additionals tend to show whether or not companies are unduly optimistic in closing cases, or, if claims were never listed, the system for recording claims in the account-

ing or statistical department is ineffective. In submitting the report of examination, it is the practice to analyze the changes in reserves by lines, showing first claims paid since date of statement and then the outstanding claims, giving the comparison between the company's reserves and the examiner's reserves.

In comparison with reserves for policyholders, the remaining liabilities are usually not large, either in number or amount. Both the commission liability and the liability for taxes can be estimated fairly close. Unpaid bills as of date of statement are checked and the total amount paid or still outstanding is set up. Unpaid dividends to stockholders or profit sharing agreements, if any, are determined, and search is made for any outstanding liability due to borrowed money or suits other than those representing claims of policyholders. Contingency reserves are sometimes carried by companies to take care of some unforeseen deficiency in assets or increase in reserves. Unless they are for some definitely stated purpose, they are considered as part of the company's surplus.

The final sum of outstanding liabilities determined as above is deducted from the admitted assets. The difference represents what is often designated "surplus to policyholders." When the capital stock is separated from this amount, the surplus remaining is the index of solvency. For, after the examiner has inspected and valued the company's assets and estimated the liabilities, if there is no excess surplus over capital or if the capital is impaired, the stockholders are called upon to make good such deficiency. If the capital and surplus are not brought up to the legal requirements in the time allowed by the superintendent, the company is declared insolvent.

Following the financial statement of income, disbursements, assets and liabilities, the examiners include an underwriting and investment exhibit in the report of examination. This is a comparison of the statement items as shown in the previous report of examination with the statement in the report. This analysis shows the changes in surplus for the intervening three-year period and indicates to what such changes are due.

The foregoing summarizes the general routine of an examination; however, it is seldom that the examiner is not faced with some new problem not previously encountered since companies differ much as individuals differ. There is the difference due to

the kinds of business; for instance, the examination of a company conducting one line, exclusively, is not as complex as that of a multiple line company. Formerly, there were companies doing plate glass business only, and these companies have been extended to embrace most of the other miscellaneous lines. There is a company which does credit business only. In this case the general procedure is the same, but questions arise which are unique to that kind of business. For example, the credit company's reserve for losses is on a different basis.

There are important features peculiar to the fidelity and surety business. The taking of collateral in writing certain forms of surety bonds may be cited as an example. This collateral often amounts to thousands of dollars and consists of savings bank books, life insurance policies, personal notes, securities such as bonds and stocks, mortgage deeds, as well as jewelry and other valuables. This collateral is held by the company until the liability under the bond is ended. It does not enter the company's books and of course should not be taken credit for until the principal in the bond defaults and the company is obliged to assume the loss, then the collateral may be taken over as salvage. In the meantime the company holds the collateral in trust.

Records must be kept, accounting for all such collateral received, showing if possible the value thereof. If collateral is released, a record or receipt must show to whom it is paid. If taken by the company, a record of the losses paid must appear with the value of the collateral taken as a reimbursement. The only means of knowing whether this collateral is intact and is being properly held in trust is by means of an examination of the company records and a verification by the actual physical examination and count.

Another feature of the examination of companies doing a fidelity and surety business is the valuation of salvage. In some cases this is considerable and it is very often difficult to determine the value because of litigation or the nature of the salvage. Some companies make a practice of charging off salvage of this kind, carrying it only in Schedule X, which is provided in the convention blank for unlisted assets. If this salvage is finally sold, the recovery is entered through income. Other companies, however, prefer to take credit for salvage as a non-ledger asset.

Other features might be enumerated indefinitely. In general,



it may be said that examination is made in accordance with the express provisions of the law. The section requiring examination in the New York law specifies the examination of the "affairs" of the company. This is interpreted to mean the affairs as shown by the books and records. Other sections govern particular phases, such as investments, reserves, etc. Examination necessarily includes the general conduct of business, the systems of handling accounts and finally the management as reflected in the company's underwriting and investment policy.

In addition to the financial statement the reports include usually a brief explanation of changes made which affect the company statement.

The law provides that when the examination is completed a full and true report shall be made comprising the facts appearing upon the books and records of the company with the examiner's conclusions and recommendations. This must be duly attested to by oath. A hearing before the superintendent of insurance is also stipulated, that is, if the company has objections to the examiner's findings as given in the report. After the company has been given the opportunity to be heard the report is filed. The superintendent may withhold the report if it is deemed in the public interest to do so. It is usually the practice for newspapers to publish a summary of the reports. Each year a digest of reports of examinations made in the preceding year is included in volume III of the superintendent's annual report.

No attempt has been made in the above outline of procedure to give the detailed check of each item which finally appears in the report. Nor is it within the scope of this paper to dwell upon the various problems which develop during the course of examination. Suffice to say, that the extent of the examination depends largely upon the company under examination. The organization itself, the systems of keeping accounts and the statistical records are exceedingly important.

It is not necessary to point out to the members of this Society the rapid growth both in the number of casualty and surety companies and the volume of business conducted by these companies. The increase in the fidelity and surety, in workmen's compensation and the automobile lines alone has added materially to the work of examination.

It has been stated above that the examiners are depending more

and more upon the statistical departments for the data which must be assembled in making up the company's statement. If such data is readily accessible, the work of examination is appreciably shortened. Company officers know what is required both for annual statement and for examination purposes.

Efforts are constantly being made towards uniformity and standardization of accounting and statistical records. The members of this Society and the Association of Casualty and Surety Accountants and Statisticians have an interest in these problems and have made valuable contributions to their solution. Further studies of accounting systems and of statistical methods, particularly in the valuation of reserves, will be of incalculable value to both the companies and the supervising authorities.