CASUALTY INSURANCE ACCOUNTING AND THE ANNUAL STATEMENT BLANK

BY

THOMAS F. TARBELL

FOREWORD

The following is a revision of a paper under the same title, originally prepared by the writer and appearing in "*Proceedings*, Vol. XV, Page 141." The main purpose of the revision has been to reflect changes in item numbers, revised wordings, and treat new items, incorporated in the annual statement blank since the original paper was prepared. The writer has endeavored to clarify certain items and reflect constructive criticisms brought out in the discussion of the original paper.

Methods of casualty insurance accounting are not and probably never will become standardized. Opinions differ as to the most efficient methods of recording and compiling accounting data. The annual statement blank, however, is, with a few unimportant exceptions, uniform for all states and, accordingly, whatever accounting methods are adopted must be designed to permit the assembling of the results to conform with prescribed uniform annual statement requirements.

Insurance accounting is a highly specialized branch of accounting and because of this fact text-books on general or commercial bookkeeping and accounting are not of material benefit to the student of insurance accounting other than to ground him in fundamental principles.

The purpose of this paper is to show briefly the application of general bookkeeping and accounting principles to casualty insurance with particular reference to the requirements of the annual statement blank as respects Income, Disbursements and Ledger Assets.

The principles of double entry bookkeeping debit and credit are necessarily the same for all kinds of business enterprises. A debit represents either expense (decrease of proprietorship), an increase in an asset or a decrease in a liability; a credit represents either income (increase of proprietorship), a decrease in an asset or an increase in a liability. It is fundamental, of course, that for each debit there is a corresponding offsetting credit and vice versa. These principles as applied to casualty insurance will be illustrated in connection with consideration of various annual statement items.

The books of account used by insurance companies are basically the same as those used by other business enterprises and consist of Journal, Cash Book and Ledger. In practice, however, various journals are generally used, each for a specific purpose, and the general ledger is used for controlling or summary accounts only and various subsidiary ledgers maintained for recording details. As examples, most companies maintain separate journals for:—

Premiums written
Premiums paid
Losses paid
Expenses paid

The premium and loss journals are in turn further subdivided to show transactions by line of insurance, and in case of premiums written according to kind of premium transaction (Gross written, Return and Reinsurance); in case of losses paid according to kind of loss transaction (Gross paid, Gross salvage received, Reinsurance received).

The distinction between cash book and journal in insurance accounting as well as in the accounting of most large enterprises is not clearly drawn. As a rule, the cash book is in summary or condensed form, the supporting details being carried in various so-called journals. An illustration in connection with accounting for paid premiums is given at a later point.

A simple illustration of a general ledger controlling account supplemented by subsidiary ledger accounts is the collateral loan account. The general ledger would show only the transactions affecting the general account and a subsidiary ledger would carry the details of the accounts with the individual borrowers.

The most important divisions of the annual statement blank from the financial standpoint are as follows:

1. Income and Disbursements
2. Assets and Liabilities
3. Underwriting and Investment Exhibit

In addition, the statement contains various general interrogatories regarding the conduct of the business and numerous exhibits and supporting schedules, which have no effect upon the financial results but are designed chiefly to enable insurance departments to partially audit the statement results and provide information and publicity considered desirable from a supervisory standpoint.

Statements of most commercial enterprises are prepared upon the so-called "revenue" or "accrual" basis. The books of account show earned income and incurred expenses. Insurance companies' statements of income and disbursements are prepared upon the "cash" basis and the books of account show only cash income (or the equivalent thereof) and paid expenses, subject to a few minor exceptions hereinafter referred to. While the Underwriting and Investment Exhibit of the casualty annual statement blank assembles the year's results on a revenue basis, the difference mentioned above makes it rather difficult for one whose knowledge of accounting and statements has been confined to general commercial accounting or the study of standard accounting textbooks clearly to comprehend the insurance blank.

The principle underlying the casualty annual statement blank is, in fact, rather simple. Expressed as a formula it is as follows:

To:	Ledger assets at the beginning of the year
Add or Deduct:	Increase or decrease in capital during the year
Add:	Cash received during the year
Add:	Profit and loss adjustments in ledger assets—Increases
Deduct:	Cash disbursed during the year
Deduct:	Profit and loss adjustments in ledger assets—Decreases
Balance =	Ledger assets at the end of the year

The term cash as used in the above formula means cash or the equivalent thereof and in many instances "net" cash as will be brought out more fully upon consideration of certain specific income and disbursement items.

The annual statement blank to which all subsequent references are made is that prescribed by the National Association of Insurance Commissioners known as the "Convention Edition" and supplied to the companies for their returns as of December 31, 1940. It should be pointed out that changes in the blank are made yearly and, accordingly, item number references and descriptions of items may change in future editions. The various sections to be considered will be taken up in the order in which they appear in the statement.

Section I—Capital Stock (Page 2)

(See Exhibit 1, Page 298)

Item 1—"Amount of capital paid up December 31 of current year"

This item is merely a memorandum statement of the amount of capital paid up at the end of the year of statement.

Item 2—"Amount of ledger assets (as per balance) December 31 of previous year"

This item, which must agree with Item 32, page 4, of the previous year's statement, is the starting point of the basic formula as set out on page 296 hereof.

Item 3—"—crease of paid-up capital during the year"

This item is not an income item as it is merely an addition to or decrease of capital account. It does, however, represent cash received during the year where an increase is made and, accordingly, enters into the accounting formula. Where capital is increased the bookkeeping entries are:

Debit: Cash
Credit: Capital stock

EXHIBIT 1

2 ANNUAL STATEMENT FOR THE YEAR 1940 OF THE ______ (*Write or stamp name of Company*) Form 3

I—CAPITAL STOCK

		DOLLARS	CENTS
1. Amount of capital paid up December 31 of current year . . . . $______			
2. Amount of ledger assets (as per balance), December 31 of previous year . . . . $______			
3. ______crease of paid up capital during the year	______		
Extended at			

II—INCOME

	(1)	(2)	(3)	(4)	(5)
		DEDUCT			
	*Gross premiums, including policy and membership fees, written and renewed during the year per col. 2, VI, page 7	Return premiums	Reinsurance (written basis)	Total deductions	Net premiums written
4. Accident					
5. Health					
6. Non-cancellable accident and health					
7. Auto liability (*a*)					
8. Liability other than auto (*a*)					
9. Workmen's compensation (*b*)					
10. Fidelity.					
11. Surety					
12. Plate glass . . .					
13. Burglary and theft .					
14. Steam boiler . .					
15. Machinery . . .					
16. Auto property damage .					
17. Auto collision . .					
18. Property damage and collision other than auto . . .					
19. (*c*)______					
20. **Totals					

21. Inspections . . . .

22. Gross interest on mortgage loans, per Schedule B, less $______accrued interest on mortgages acquired during the year . . . . $______

23. Gross interest on collateral loans, per Schedule C . . . . ______

24. Gross interest on bonds $______and dividends on stocks $______
less $______accrued interest on bonds acquired during the year, per Schedule D . . ______

25. Gross interest on deposits in trust companies and banks, per Schedule N . . . . ______

26. Gross interest from all other sources (give items and amounts):

27. ______ ______

28. ______ ______

29. Gross income from company's property, including $______for company's occupancy of its own building, less $______interest on incumbrances, per Schedule A. . . . . ______

30. Total interest, dividends and real estate income . . . . . .

31. From other sources (give items and amounts):

32. ______ $______

33. ______ ______

34. Increase in liabilities during the year on account of reinsurance treaties . . . .

35. Remittances from home office to United States branch (gross) . . . .

36. †Borrowed money gross $______less amount repaid $______ . . . .

37. From agents' balances previously charged off . . . .

38. Gross profit on sale or maturity of ledger assets, viz:
(a) Real estate, per Schedule A. $______
(b) Bonds, per Schedule D . . . . ______
(c) Stocks, per Schedule D. . . . . ______
(d) ______ ______

39. Gross increase by adjustment in book value of ledger assets, viz:
(a) Real estate, per Schedule A. $______
(b) Bonds, per Schedule D (including $______for accrual of discount) . . . . . . ______
(c) Stocks, per Schedule D . . . . ______
(d) ______ ______

40. **Total Income** . . . .

41. ______ Amount carried forward

*By gross premiums is meant the aggregate of all the premiums written in the policies or renewals issued during the year. Are they so returned in this statement? Answer:______

**To be supported by distribution of premiums by states as per Schedule T.

(*a*) Including net premiums on policies issued in previous years. Indicate refunds by minus sign.

1939, $______; 1938, $______; 1937, $______
1936, $______; 1935, $______; prior to 1935, $______

(*b*) Including net premiums on policies issued in previous years. Indicate refunds by minus sign.

1939, $______; 1938, $______; 1937, $______
1936, $______; 1935, $______; prior to 1935, $______

†Company is at liberty to state transaction briefly, so that explanation can be carried as footnote in department report.

(*c*) Enter line of business.

SECTION II—INCOME (Page 2)

(See Exhibit 1, Page 298)

Items 4-20—Premium Income

The annual statement blank requires that premiums be reported on a "written" instead of a "paid" basis. Hence, written premiums for statement purposes are considered as the equivalent of cash. Premiums are reported by line of insurance and according to kind of premium transaction. The "net" credit balances of the various premium accounts are shown on the income page.

Since written premiums are credited but the cash not necessarily received until sometime subsequently, it is necessary to set up ledger asset accounts in which to carry the premiums receivable until they are collected. These accounts are known as "Premiums in course of Collection" (Items 9-25, Page 4 of statement).

The bookkeeping entries involved in the various kinds of premium transactions for each line of insurance are as follows:

(1) Gross premiums, etc.
Debit: Premiums in course of collection
Credit: Gross premiums written

(2) Return premiums
Debit: Cancelation, return or "not taken" premiums
Credit: Premiums in course of collection

(4) Reinsurance (written basis)

Gross written

Debit: Reinsurance premiums written
Credit: Reinsurance premiums payable

Not taken and canceled (or return)

Debit: Reinsurance premiums payable
Credit: Reinsurance premiums written

Note that it is not necessary to keep reinsurance premium accounts subdivided according to gross and canceled.

Premiums in course of collection and reinsurance premiums payable receive further consideration in connection with SECTION IV—LEDGER ASSETS (Page 4 of statement).

Item 21—"Inspections"

This item represents income received by a company for inspecting mechanical equipment, usually steam boilers, where a regular inspection and indemnity contract is not carried in the company.

The bookkeeping entries are:

Debit: Cash
Credit: Inspections

Items 22-28—Interest Received on Various Forms of Ledger Assets

These items represent net cash received—gross cash less amount paid for accrued interest, if any. The bookkeeping entries can be best illustrated by an example: Assume a 3% bond for $1000 with interest payable semi-annually acquired at par value plus three months accrued interest. The bookkeeping entries at purchase for the interest part of the transaction would be:

Debit: Bond interest (or bond interest accrued) $7.50
Credit: Cash $7.50

When the next coupon due was collected the entries would be:

Debit: Cash $15
Credit: Bond interest $15

The net interest received would be $7.50.

Item 29—"Gross income from company's property, including $——— for company's occupancy of its own building, less $——— interest on incumbrances, per Schedule A"

This item may involve three accounts—Rents received, Rents paid and Interest on mortgages payable.

The bookkeeping entries for space leased or rented to tenants would be:

Debit: Cash
Credit: Rents received

The bookkeeping entries for rent charged the company by itself for its own occupancy would be:

Debit: Rents paid
Credit: Rents received

The bookkeeping entries in connection with interest paid on incumbrances (mortgages) would be:

Debit: Interest on mortgages payable
Credit: Cash

Items 31-33—"From other sources (give items and amounts):"

These lines are intended to provide for miscellaneous and unusual income or cash received transactions and profit and loss adjustments not otherwise provided for. As an example, surplus paid in by stockholders would be reported in one of these lines. Such surplus is not income but merely an addition to surplus account. The bookkeeping entries would be:

Debit: Cash
Credit: Profit and loss (surplus paid in)

Occasionally companies, in order to provide additional surplus, reduce the par value of their stock and transfer the difference between the amounts at the old and new par values to surplus. In such cases the decrease in capital would be reported in Item 3 and the corresponding surplus gain in one of the Items 32-33 under some such description as "Surplus transferred from capital account." The bookkeeping entries would be as follows:

Debit: Capital
Credit: Profit and loss (capital transferred to surplus)

Item 34—"Increase in liabilities during the year on account of reinsurance treaties"

This is not a true income item and has no effect upon the profit or loss of the company, as the amount is offset by a corresponding liability.

It is a condition of certain reinsurance agreements that the ceding company shall retain a certain percentage of the premium ceded for a certain period of time as a financial guarantee that the reinsuring company (frequently a foreign or alien company not authorized to transact business in the United States) will carry out the terms of the treaty. The amounts so retained are known as "Funds held under reinsurance treaties." Such funds are, in effect, similar to borrowed money (see item 36, page 2 of statement), since they represent a liability to the reinsuring company as the funds will ultimately be paid over to such company provided the conditions of the treaty are fulfilled. The ceding company does not receive cash from the reinsuring company, but the ceding company's ledger assets are increased since the "Reinsurance premiums payable" account is debited for the amount of such funds. As this is a credit balance account, the effect of debiting the account is to increase the general asset account "Premiums in course of collection." The effect is the same as if the ceding company actually paid the full (100%) amount of reinsurance premiums to the reinsuring company and that company, in turn, returned to the ceding company its check for the portion to be retained by the ceding company. In such a case, there would be an actual cash income item (which would be offset by the corresponding liability item "Funds held under reinsurance treaties"). From the foregoing it is obvious that the amount of funds withheld must be reflected in the income page of the statement in order to preserve the balance of the formula stated on Page 296.

When any part of such funds is paid over to the reinsuring company, the ledger asset "Cash" is decreased by the amount of such payment and such decrease must be reflected in the disbursement page. However, since only the net amount of increase or decrease in ledger assets is of consequence, the blank provides that only such net amount be entered as an income or disbursement item, as the case may be (see also Item 55, EXHIBIT 2—DISBURSEMENTS, Page 3 of statement).

The bookkeeping entries in connection with funds withheld are:

Debit: Reinsurance premiums payable
Credit: Funds held under reinsurance treaties

and in connection with funds paid over to the reinsuring company:

Debit: Funds held under reinsurance treaties
Credit: Cash

Item 35—"Remittances from home office to United States branch (gross)"

This item applies only to the United States branches of foreign (alien) companies. It represents funds supplied by the Home

Office for capital and surplus purposes and is not income. The bookkeeping entries are:

Debit: Cash
Credit: Remittances from home office

Item 36—"Borrowed money gross $——— less amount repaid $———"

Borrowed money does not represent true income and has no effect upon the profit or loss of the company as the amount is offset by a corresponding liability. However, cash is received and the ledger assets are increased and, accordingly, the amount of increase must be reflected in the income page of the statement in order to preserve the balance of the formula stated on Page 296.

Similarly, when borrowed money is repaid, ledger assets are decreased by the cash paid out and the amount of decrease must be reflected in the disbursement page. However, since only the net amount of increase or decrease in ledger assets is of consequence, the blank provides that only such net amount be extended as an income or disbursement item, as the case may be (see also Item 57, EXHIBIT 2—DISBURSEMENTS, Page 3 of statement).

The bookkeeping entries at the time the money is borrowed are:

Debit: Cash
Credit: Borrowed money

and at the time of repayment

Debit: Borrowed money
Credit: Cash

Item 37—"From agents' balances previously charged off"

This item arises when a balance due from an agent and charged off as uncollectible is subsequently recovered. The bookkeeping entries are as follows:

Debit: Cash
Credit: Profit and loss (Agents' balances)

This item is further discussed in connection with Item 59, Page 3 of statement, "Agents' balances charged off," and Items 8-25, EXHIBIT 3—LEDGER ASSETS, Page 4 of statement.

Item 38—"Gross profit on sale or maturity of ledger assets"—Real estate, Bonds, Stocks or other ledger assets

The profit (or loss) on sale of ledger assets is the difference between the book value (not the actual cost, unless book value and actual cost are the same) at date of sale and the sale price. The bookkeeping entries for the profit portion are:

Debit: Cash
Credit: Profit and loss—profit on sale of (real estate, bonds, stocks or other ledger assets)

There are two methods of accounting for profit and loss items in general use. One method (that followed in this paper) is to charge or credit such items as profit or loss on sale direct to a single controlling Profit and Loss ledger account and maintain subsidiary accounts for the details required by the annual statement. The second method is to carry separate profit and loss ledger accounts for each such annual statement item. Where the second method is followed the account credited in the above example would be "Profit on sale of (real estate, bonds, stocks or other ledger assets)."

Item 39—"Gross increase by adjustment in book value of ledger assets"—Real estate, Bonds, Stocks or other ledger assets

This item does not represent cash income or profit but is in the nature of accrued income or profit. Some companies follow the practice of maintaining the book values of real estate, bonds and stocks at approximately the market values. Profit and loss entries are made at the end of the year to bring the book values up to the approximate market values. The bookkeeping entries are:

Debit: Real estate, bonds, stocks or other ledger assets (book value)
Credit: Profit and loss—Increase by adjustment in book value of (real estate, bonds, stocks or other ledger assets)

In case of bonds a further use is made of this item by companies which value their bond holdings on the amortization basis, which is common practice at the present time as such basis is required by at least one state. If a bond is acquired at a discount, the effective rate of interest will be in excess of the nominal rate. Assume that the nominal (coupon) rate is 3%, the purchase price 98 and the term to maturity 9½ years. The effective rate of interest, as determined by reference to any standard table of bond values is 3¼%. If the bond were carried upon the books at $980 until maturity, a false profit on maturity of $20 would be shown and the interest income during the period would be too small, since it is reasonable to assume that the effective rate of 3¼% represents a fair interest return on funds invested at the time of purchase of the bond. The company would, however, receive only the nominal interest of 3% during the term of the bond, the additional interest being deferred and accumulated at the effective rate until maturity. Such deferred interest would be taken credit for by adding the yearly accrual to the book value of the bond. The bookkeeping entries would be:

Debit: Bonds (book value)
Credit: Profit and loss—accrual of bond discount

The foregoing is an exception to the general rule that the statement is based upon cash income or receipts.

It will be shown upon consideration of SECTION IV—ASSETS (Page 4 of statement) that increases (or decreases) by adjustment are unnecessary so far as the effect of changes in security values upon surplus and total admitted assets are concerned. They do, however, affect the amount of ledger assets.

Item 40—"Total Income"

This is the sum of the extended amounts of Items 20, 21, 30 and 33-39.

Item 41—"Amount carried forward"

This is the sum of the ledger assets at beginning of year, plus or minus the increase or decrease in capital during the year, and total income (Item 40).

EXHIBIT 2

Form 3 ANNUAL STATEMENT FOR THE YEAR 1940 OF THE ______________________ 3

(*Write or stamp name of Company*)

DOLLARS | CENTS

Amount brought forward,

III—DISBURSEMENTS

	(1) Gross amount paid for losses	DEDUCT (2) Gross salvage (Sched. H)	(3) Reinsurance	(4) Total deduction	(5) Net amount paid policyholders for losses
1. Accident					
2. Health					
3. Non-cancellable accident and health					
4. Auto liability					
5. Liability other than auto					
6. Workmen's compensation					
7. Fidelity					
8. Surety					
9. Plate glass					
10. Burglary and theft					
11. Steam boiler					
12. Machinery					
13. Auto property damage					
14. Auto collision					
15. Property damage and collision other than auto					
16. (a)______					
17. TOTALS					

18. Investigation and adjustment of claims, viz:
19. Accident $______; Health $______; Non-cancellable accident and health $______;
20. Auto liability $______; Liability other than auto $______; Workmen's compensation $______;
21. Fidelity $______; Surety $______; Plate glass $______;
22. Burglary and theft $______; Steam boiler $______; Machinery $______;
23. Auto property damage $______; Auto collision $______; Property damage and collision other than auto $______;
24. (a)______ $______;
25. Policy and membership fees retained by agents $______
26. Commissions or brokerage, less amount received on return premiums and reinsurance for the following classes
27. Accident $______; Health $______; Non-cancellable accident and health $______;
28. Auto liability $______; Liability other than auto $______; Workmen's compensation $______;
29. Fidelity $______; Surety $______; Plate glass $______;
30. Burglary and theft $______; Steam boiler $______; Machinery $______;
31. Auto property damage $______; Auto collision $______; Property damage and collision other than auto $______;
32. (a)______ $______;
33. Salaries and all other compensation of officers, directors, trustees and home office employees
33(a). Pension, retirement and other similar benefits
34. Home office travel
35. Salaries, traveling and all other expenses of branch offices and agents, excluding commissions
36. Salaries, traveling and all other expenses of payroll auditors
37. Inspections, including accident prevention $______; medical examiners' fees and salaries $______
38. Rents, including $______for company's occupancy of its own buildings
39. General office maintenance and expense
40. Taxes, licenses and fees:
    - (a) State taxes on premiums $______
    - (b) Insurance department
    - (c) Other state taxes, including $______social security
    - (d) Federal, including $______social security
    - (e) All other (except on real estate)
41. Legal expenses $______; advertising $______; printing and stationery $______
42. Postage, telegraph, telephone, exchange and express $______; insurance $______
43. Furniture and fixtures $______; books, newspapers and periodicals $______
44. Bureau and association dues and assessments
45. Miscellaneous underwriting expense (itemize)______
46. ______
47. ______
48. Real estate: (a) repairs and expenses $______; (b) taxes $______
49. Miscellaneous investment expense (itemize)______ $______
50. ______
51. Stockholders for dividends (amount declared during the year, cash $______; stock $______)
52. Policyholders for dividends, less $______dividends received from reinsuring companies
53. Other disbursements (itemize)______
54. ______
55. Decrease in liabilities during the year on account of reinsurance treaties
56. Remittances to home office from United States branch (gross)
57. Borrowed money repaid gross $______less amount borrowed $______
58. Interest on borrowed money
59. Agents' balances charged off
60. Gross loss on sale or maturity of ledger assets, viz:
    - (a) Real estate, per Schedule A $______
    - (b) Bonds, per Schedule D
    - (c) Stocks, per Schedule D
    - (d) ______
61. Gross decrease, by adjustment, in book value of ledger assets, viz:
    - (a) Real estate, per Schedule A $______
    - (b) Bonds, per Schedule D (including $______for amortization of premiums)
    - (c) Stocks, per Schedule D
    - (d) ______
62. **Total Disbursements**
63. BALANCE

(a) Enter line of business.

SECTION III—DISBURSEMENTS (Page 3)

(See Exhibit 2, Page 306)

Items 1-17—Losses Paid

Accounting procedure in connection with losses paid is comparatively simple so far as annual statement requirements are concerned. The bookkeeping entries for each of the various kinds of loss transactions for each line of business are as follows:

(1) Gross amount paid for losses
 Debit: Losses
 Credit: Cash

(2) Gross salvage
 Debit: Cash
 Credit: Salvage recovered

(3) Reinsurance
 Debit: Cash
 Credit: Reinsurance recovered

In cases where salvage has been recovered on a paid loss under which there was reinsurance the original company would refund to the reinsuring company its proportion of the salvage recovery. The bookkeeping entries on payment to the reinsuring company would be:

Debit: Reinsurance recovered
Credit: Cash

At first glance it would appear that this method of accounting is incorrect and that the bookkeeping entries should be:

Debit: Salvage
Credit: Cash

It will be noted, however, that the heading "Gross" precludes any debit entries to the salvage account and an example will show that the prescribed method is correct.

Assume that a company pays a gross loss of $1000 and that the risk is one-half reinsured. The statement as respects this item would appear as follows:

Gross Amount Paid	Salvage	Reinsurance	Total Deduction	Net Amount Paid
$1,000.00	......	$500.00	$500.00	$500.00

If $500 salvage were subsequently received the statement under the prescribed method would show:

(a) Gross Amount Paid	Salvage	Reinsurance	Total Deduction	Net Amount Paid
$1,000.00	$500.00	$250.00	$750.00	$250.00

and under the incorrect method:

(b) Gross Amount Paid	Salvage	Reinsurance	Total Deduction	Net Amount Paid
$1,000.00	$250.00	$500.00	$750.00	$250.00

Since reinsurance applies to the net loss sustained by a company, method (a) is obviously correct as it shows reinsurance equal to 50% of the net loss — $250.00 ÷ ($1000.00 — $500) and method (b) incorrect since it shows reinsurance equal to 66⅔% of the net loss — $500.00 ÷ ($1000.00 — $250.00).

Reinsurance is usually collected sometime after the gross loss is paid. This results in reinsurance recoverable and some companies prefer to credit this to loss account immediately. This procedure is similar in theory to the crediting of written premiums. To accomplish this result a ledger asset account "Reinsurance recoverable on paid losses" is set up and the bookkeeping entries become:

Debit: Reinsurance recoverable (on paid losses)
Credit: Reinsurance recovered

Items 18-50 and 53 and 54—Expenses

These items cover various underwriting (claim, acquisition, administration, inspection, tax and bureau) and investment (real estate and other) expenses. No special accounting procedure is involved except in connection with claim, Items 18-24, branch office, Item 35, payroll audit, Item 36, and inspection, Item 37, expenses. The usual bookkeeping entries are:

Debit: Expense (by item)
Credit: Cash

Claim expense is divided into two parts—allocated and unallocated. Allocated expense is that chargeable to specific claims, such as attorneys' and court fees, cost of medical examinations (in public liability claims) and cost of appraisals (in case of property damage losses). Unallocated claim expense consists of the general overhead cost of maintaining claim service, both in the field and at the Home Office, comprising such items as salaries, traveling expense, rent, heat, light, printing and stationery, furniture and fixtures, etc. Separate ledger accounts are maintained for assigned loss expense by line the same as in the case of losses. Separate ledger accounts are also usually maintained for claim salaries and claim traveling expense, but not by line of insurance. The problem of determining what proportion of field and home office rent, heat, light, printing and stationery, furniture and fixtures, should be charged to claim expense and the further distribution of such proportions plus claim salaries and claim traveling expenses to the various lines of insurance involves the application of advanced cost accounting principles and the treatment of this phase of accounting, even briefly, is beyond the scope of this paper.

Problems similar to those involved in determining unallocated claim expense are encountered in determining branch office, payroll audit and inspection expense, since these expenses are also made up of salaries, traveling expense, rent, heat, light, printing and stationery, furniture and fixtures, etc.

It is obvious from the foregoing that the disbursements as shown on Page 3 of the statement will not check with the Trial Balance as respects many items—salaries, traveling expense, rents, printing and stationery, furniture and fixtures, etc.

Item 51—"Stockholders for dividends (amount declared during the year, cash $———; stock $———)"

This item requires no special comment. The provision for showing in parenthesis dividends declared during the year is to provide a check on the liability for unpaid dividends, Page 5 of statement. The bookkeeping entries involved in the dividend account are as follows:

Debit: Dividends paid
Credit: Cash

Item 52—"Policyholders for dividends, less $——— dividends received from reinsuring companies"

This item is peculiar to mutual companies or stock companies writing participating contracts. It involves no unusual accounting principles. Note, however, that dividends paid are net—gross paid less dividends received from reinsuring companies. Separate accounts are maintained—one for gross dividends and the other for reinsurance dividends. The bookkeeping entries are as follows:

Gross dividends paid
Debit: Dividends to policyholders
Credit: Cash

Reinsurance dividends received
Debit: Cash
Credit: Reinsurance dividends

Item 55—"Decrease in liabilities during the year on account of reinsurance treaties"

This item is explained in connection with Item 34, Page 2 of statement.

Item 56—"Remittances to home office from United States branch (gross)"

This item is the opposite of Item 35, Page 2, and represents surplus funds returned to home office. The bookkeeping entries are:

Debit: Remittances to home office
Credit: Cash

Item 57—"Borrowed money repaid gross $——— less amount borrowed $———"

This item is explained in connection with Item 36, Page 2 of statement.

Item 58—"Interest on borrowed money"

This item is self-explanatory. The bookkeeping entries are, of course:

Debit: Interest on borrowed money
Credit: Cash

Item 59—"Agents' balances charged off"

These are profit or loss items representing the charge-off of balances considered as uncollectible.

There are two types of such items. One arises from errors in agents' paid premium reports or incorrect remittances discovered upon audit of reports in either the branch or home office. If a premium or commission is incorrectly reported or the amount of the net remittance of the agents is incorrect, the correct premium or commission amounts are charged or credited to the appropriate accounts and the difference or balance is charged or credited to a ledger asset account generally known as "Agents' sundry balances" (see EXHIBIT 3—OTHER LEDGER ASSETS, Items 27-31, page 4 of statement). These differences or balances are usually adjusted in subsequent reports, but if for any reason a company is unable to collect such a balance from an agent, the balance is charged off to profit and loss through the above account. The bookkeeping entries are:

Debit: Profit or loss (Agents' balances charged off)
Credit: Agents' sundry balances

The other type arises where an agent has collected premiums from assureds but has failed to remit them to the company. These are termed defalcations or "shortages." This type of case is usually cleared directly to profit and loss. Since the premiums actually have been paid, it is necessary to clear them from the "Premiums in course of collection" account. The transaction is carried out by the preparation of a dummy paid-premium voucher providing the following bookkeeping entries (assuming premiums of $1,000 and commissions of $250):

	Debit	Credit
Profit and loss (Agents' balances charged off)	$ 750.00	....
Commissions	250.00	....
Premiums in course of collection	....	$1,000.00
	$1,000.00	$1,000.00

Item 60—"Gross loss on sale or maturity of ledger assets"—Real estate, bonds, stocks or other ledger assets

This is the opposite of Item 38, Page 2. The bookkeeping entries, so far as the loss on sale is concerned, are:

Debit: Profit and loss—loss on sale of (real estate, bonds, stocks or other ledger assets)
Credit: Real estate, bonds, stocks or other ledger assets (book value)

The bookkeeping entries for both Items 38, Page 2, and 60, Page 3, are further illustrated in the consideration of SECTION IV —LEDGER ASSETS (Page 4 of statement), Item 4—"Book value of bonds"

Item 61—"Gross decrease by adjustment in book value of ledger assets"—Real estate, bonds, stocks or other ledger assets

This item is the reverse of Item 39, Page 2. For ordinary adjustments to bring the book value down to the market value the bookkeeping entries are:

Debit: Profit and loss—increase by adjustment in book value of (real estate, bonds, stocks or other ledger assets)
Credit: Real estate, bonds, stocks or other ledger assets (book value)

In case of companies valuing their bonds on the amortization basis the process is the reverse of that illustrated in connection with Item 39, Page 2. If a bond is acquired at a premium the effective rate of interest will be less than the nominal rate. Assume that the nominal (coupon) rate is 4%, the purchase price 111 and the term to maturity 20 years. The effective rate of interest would be 3¼%. Under these circumstances the excess of the nominal interest over the effective interest would be used to amortize the premium over the term of the bond so that at maturity the bond would stand on the books at its par value. The bookkeeping entries would be:

Debit: Profit and loss—amortization of bond premiums
Credit: Bonds (book value)

Item 62—"Total Disbursements"

This item is the sum of the extended amounts of Items 17, 24, 47, 48 and 50-61.

Item 63—"Balance"

This item is the difference between the item "Amount brought forward" at the top of the page and Item 62. It balances with Item 32, Page 4 of statement (see Exhibit 3, Page 314).

Section IV—Assets (Page 4)

(See Exhibit 3, Page 314)

This section is divided into three subsections:

(1) Ledger Assets
(2) Non-Ledger Assets
(3) Assets Not Admitted

(1) Ledger Assets

Items 1-4—Investments—Real estate, Mortgage loans, Collateral loans, Bonds and Stocks

These items call for the book values of the various forms of investments. It should be noted that Item 1 provides for the deduction of incumbrances from the book value of real estate and the showing of only the net value as a ledger asset. This is not in accordance with the usual accounting practice of showing the gross value as an asset and mortgage incumbrances as a liability.

When an investment is made the bookkeeping entries are:

Debit: Real estate, mortgage loans, etc.
Credit: Cash

When an investment matures or is disposed of the bookkeeping entries are:

Debit: Cash
Credit: Real estate, mortgage loans, etc.

EXHIBIT 3

4 ANNUAL STATEMENT FOR THE YEAR 1940 OF THE ______________________ Form 3
(*Write or stamp name of Company*)

IV—LEDGER ASSETS

			DOLLARS / CENTS	DOLLARS / CENTS
1. Book value of real estate (less $______ incumbrances), per Schedule A				
2. Mortgage loans on real estate per Schedule B, first liens $______ other than first______				
3. Loans secured by pledge of bonds, stocks or other collateral, per Schedule C				
4. Book value of bonds, $______; and stocks, $______, per Schedule D				
5. Cash in company's office	$______			
6. Deposits in trust companies and banks not on interest, per Schedule N	______			
7. Deposits in trust companies and banks on interest, per Schedule N	______			
8. Gross premiums, less return premiums and reinsurance, in course of collection, viz:	(1) On policies or renewals effective on or after October 1 of current year	(2) On policies or renewals effective prior to October 1 of current year		
9. Accident	$	$		
10. Health				
11. Non-cancellable accident and health				
12. Auto liability				
13. Liability other than auto				
14. Workmen's compensation				
15. Fidelity				
16. Surety				
17. Plate glass				
18. Burglary and theft				
19. Steam boiler				
20. Machinery				
21. Auto property damage				
22. Auto collision				
23. Property damage and collision other than auto				
24. (a)______				
25. TOTALS	$	$		
26. Bills receivable				
27. Other ledger assets, viz:				
28. ______		$		
29. ______				
30. ______				
31. ______				
32. Ledger Assets, as per Balance on page 3				

NON-LEDGER ASSETS

		DOLLARS / CENTS	DOLLARS / CENTS
33. Gross interest due, $______ and accrued, $______ on mortgages, per Schedule B			
34. Gross interest due, $______ and accrued, $______ on collateral loans, per Schedule C, Part I			
35. Gross interest due, $______ and accrued, $______ on bonds, not in default, per Schedule D, Part I			
36. Gross interest due, $______ and accrued, $______ on other assets (give items and amounts):			
37. ______			
38. Gross rents and interest due, $______ and accrued, $______ on company's property or lease			
39. Market value of real estate over book value, per Schedule A			
40. *Market / Amortized or investment } value (not including interest in Item 35) of bonds over book value, per Schedule D			
40A. Market value of stocks over book value, per Schedule D			
41. Other non-ledger assets, viz:			
42. ______	$		
43. ______			
44. Gross Assets			

DEDUCT ASSETS NOT ADMITTED

		DOLLARS / CENTS	DOLLARS / CENTS
45. Company's stock owned, $______; loans on, $______	$		
46. Supplies, printed matter and stationery			
47. Furniture, fixtures and safes			
48. Gross premiums in course of collection effective prior to October 1 of current year			
49. Bills receivable			
50. Loans on personal security, endorsed or not			
51. Deposits in suspended banks, less $______ estimated amount recoverable			
52. Book value of real estate over market value, per Schedule A			
53. Book value of bonds over { *market / amortized or investment } value, per Schedule D			
53A. Book value of stocks over market value, per Schedule D			
53B. Interest due and accrued on mortgage loans (state basis)			
53C. ______			
54. Other assets not admitted, viz:			
55. ______			
56. ______			
57. ______			
58. Total Admitted Assets			

(a) Enter line of business.
*Strike out "Market" or "Amortized or investment."

Where there is a profit or loss on sale or maturity at least three and in some instances four accounts are affected. Examples using the sale of a bond at a profit and a loss will illustrate. Assume that a bond carried at a book value of $980 is sold for par ($1000) and accrued interest of $15. The bookkeeping entries would be as follows:

	Debit	Credit
Cash	$1,015.00	....
Bonds (book value)	....	$ 980.00
Profit and loss—profit on sale of bonds	....	20.00
Bond interest	....	15.00
	$1,015.00	$1,015.00

If the book value and sale amounts were reversed, i.e., book value $1000 and sale price $980 plus accrued interest of $15, the bookkeeping entries would be as follows:

	Debit	Credit
Cash	$ 995.00	....
Bonds (book value)	....	$1,000.00
Profit and loss—loss on sale of bonds	20.00	....
Bond interest	....	15.00
	$1,015.00	$1,015.00

Item 5—"Cash in company's office"

This item is self-explanatory. It includes within its scope actual cash and cash items—checks, drafts and money orders.

In order to conveniently record the various bookkeeping entries arising from either of the above transactions, a voucher would be prepared showing the four debits and credits. The cash would be posted in the cash book and the other entries in a journal designed to provide for entries such as the foregoing. Many companies maintain what is known as a cash-journal, a combination of cash book and journal, and in such cases all four entries would be posted in this book.

Items 6 and 7—Deposits in Trust Companies and Banks

Heretofore in all examples of bookkeeping entries involving actual receipts and disbursements, it has been assumed that such receipts and disbursements have been in the form of cash and for simplicity of illustration "Cash" has been used as the account involved. In practice, however, only a small part of the actual business transactions of an insurance company involve actual cash but are represented by check receipts and disbursements. Accordingly, companies maintain, in addition to a pure cash account, separate ledger accounts with various banks. Checks received are usually charged to cash through the medium of the cash book and subsequently credited to cash and charged to the bank of deposit. Debit may be, and frequently is, made direct to the bank without the intermediate step of passing through the cash book. Under the latter conditions the bookkeeping debit would be to "Bank" instead of to "Cash." As an example the bookkeeping entries in connection with rents received (see page 300) would be:

Debit: Bank (by name)
Credit: Rents received

Disbursements, except for petty cash items, are almost invariably made by check and charged direct to the bank upon which they are drawn. Using gross losses paid, for example, the bookkeeping entries in actual practice (see Page 307) would be:

Debit: Losses
Credit: Bank (by name)

Items 8-25—"Gross Premiums, less return premiums and reinsurance, in course of collection"—(by line of insurance)

The function of these items has been explained in connection with the consideration of Items 4-20, Page 2 of statement. The significance of the word "Gross" is usually interpreted as meaning "without deduction of commissions." These accounts consist of the net amount of unpaid direct and assumed reinsurance premiums (gross, less not taken and return) minus the net amount of reinsurance ceded premiums payable.

When premiums are collected two asset and one disbursement accounts are affected, since premiums are remitted "net" (less commissions) by agents. Cash is debited, premiums in course of collection are credited and commissions are debited. If premiums to the gross amount of $1000, with a commission rate of 25% were remitted, the bookkeeping entries would be:

	Debit	Credit
Cash (or bank).................	$ 750.00	....
Premiums in course of collection..	....	$1,000.00
Commissions paid................	250.00	....
	$1,000.00	$1,000.00

On payment of reinsurance ceded premiums by the company the bookkeeping entries, assuming gross reinsurance ceded premiums of $1000 and a commission rate of 35%, would be:

	Debit	Credit
Cash (or bank).................	....	$ 650.00
Reinsurance premiums payable...	$1,000.00	....
Commissions paid................	....	350.00
	$1,000.00	$1,000.00

In actual practice the bookkeeping is handled somewhat differently from the simple illustrations above. In case of direct business a summary of the premium, commission and any other charges or credits and the net cash remitted, usually referred to as a "Paid Premium Report" or "Account Current," would accompany the remittance. Using this as a voucher the net cash would be debited on the cash book or to the bank and the remaining items posted to the paid premium journal. At the end of the month the total debits and credits would be posted therefrom to the appropriate ledger accounts—premiums in course of collection, commissions and expense (by account), if any.

Item 26—"Bills receivable"

This item is of slight consequence in the accounts of insurance companies and involves no special accounting consideration. If a note were accepted from an agent for a balance due for premiums, the bookkeeping entries would be the same as in the foregoing illustration except that bills receivable would be debited instead of cash or bank. When the note was paid, the bookkeeping entries would be:

Debit: Cash (or bank)
Credit: Bills receivable

Items 27-31—"Other ledger assets, viz:"

The more important items usually found in these lines are "Reinsurance recoverable on paid losses," referred to in connection with the consideration of paid losses, Items 1-17, Page 3 of statement, and "Agents' sundry balances," referred to in connection with consideration of Item 59, Page 3 of statement.

When the reinsurance recoverable mentioned on page 308 is actually paid by the reinsuring company, the bookkeeping entries are:

Debit: Cash (or bank)
Credit: Reinsurance recoverable on paid losses

An example of an entry affecting the "Agents' sundry balances" account would be the case where an agent in reporting a premium of $1000 carrying a commission rate of 12½% incorrectly computed the commission at 15%. The bookkeeping entries would be:

	Debit	Credit
Cash (or bank)	$ 850.00	....
Agents' sundry balances	25.00	....
Premiums in course of collection	....	$1,000.00
Commissions paid	125.00	....
	$1,000.00	$1,000.00

Item 32—"Ledger Assets, as per Balance on Page 3"

This item is the sum of Items 1-4, 7, 25, 26 and 31, and, as indicated and also previously pointed out, must agree with Item 63, Page 3.

With the exception of "Capital," "Funds held under reinsurance treaties," "Borrowed money" and a few other ledger liability items of rather infrequent occurrence, all items which are derived from the Trial Balance of a company have been considered and the main purpose of the paper accomplished. Accordingly, consideration of the balance of the financial statement is made as brief as possible.

(2) Non-Ledger Assets

Items 33-37—Interest due and accrued on various ledger assets

These items are necessary to compute the actual interest earned during the year. Their determination is mainly a matter of the arithmetical computation and summarization of detail items.

Item 38—"Gross rents and interest due, $——— and accrued, $——— on company's property or lease"

This item is similar to Items 33-37. The inclusion of the words "or lease" is to take care of the case where a company leases a building or a portion thereof and subleases a part or parts thereof to other tenants. The rent received from subleases is reported as a credit to rents—Item 38, Page 3 of statement.

Item 39—"Market value of real estate over book value, per Schedule A"

Insurance companies are required to compile their statements upon market values of assets. If the market value exceeds the book value, the excess is treated as a non-ledger asset.

Item 40—"* Market
Amortized or investment } value (not including interest in Item 35) of bonds over book value, per Schedule D"

* Strike out "Market" or "Amortized or investment."

This item is similar to Item 39. The alternative provisions for "Market" or "Amortized or investment" are included to provide for the particular basis on which a company values its bonds. They are not optional provisions, which would permit a company to use the higher of the two values. For example, if a company values its bonds on the amortized basis, which is the usual practice (see Item 39, Page 2), it must use the amortized values in determining the amount to be entered in Item 40, regardless of whether such values are greater or less than the market values.

Item 40A—"Market value of stocks over book value, per Schedule D"

This item is similar to Items 39 and 40 and requires no particular comment.

Items 41-43—"Other non-ledger assets, viz:"

These items are to provide for unusual or infrequent non-ledger assets. In the case of a company which does not credit losses for reinsurance recoverable at the time of paying the gross loss (see comments on reinsurance losses, page 308) but only upon collection of the reinsurance the "Reinsurance recoverable on paid losses" would be carried as a non-ledger asset.

Item 44—"Gross Assets"

This item which is self-explanatory is the sum of Items 32, 38-40A and 43.

(3) ASSETS NOT ADMITTED

From the "Gross Assets" certain deductions are made to arrive at the "Admitted Assets." These deductions consist of (1) assets of doubtful value in fact or arbitrarily so classified by law or rulings of insurance departments and (2) excesses of book values of assets over market (or amortized) values.

Item 45—"Company's stock owned, $———; loans on, $———"

Such items are of rare occurrence. Their treatment as non-admitted assets is, of course, logical.

Items 46 and 47—"Supplies, printed matter and stationery" and "Furniture, fixtures and safes"

The treatment of the above items as non-admitted assets is open to question. Supplies, printed matter and stationery have a certain asset value, especially to a going concern, and furniture and fixtures unquestionably have an asset value, both on the basis of a going concern and because of their resale value. The fact that no asset value is permitted for these items is probably due to difficulties incident to a proper appraisal of their worth.

In view of the fact that no asset value is permitted for the above items, most companies carry no asset accounts for the same but treat all purchases as expense.

Item 48—"Gross premiums in course of collection effective prior to October 1 of current year"

This item is similar to the item frequently found in the statements of manufacturing and merchandising corporations under the caption "Reserve for bad debts." It should be noted, however, that insurance companies are not permitted to exercise any judgment in determining the amount of the item but are required to consider all premiums outstanding more than three months as uncollectible or of no value. Experience shows that as a matter of fact only a small proportion of such items are eventually charged off as uncollectible.

Items 49 and 50—"Bills receivable" and "Loans on personal security, endorsed or not"

The treatment of these items in their entirety as non-admitted assets is open to debate. Notes may be taken from agents as a last resort to effect collection of premium balances. On the other hand, notes or interest bearing warrants sometimes issued by municipalities in payment of premiums and assumed by a company from its agents are usually perfectly good assets. Loans on personal security are of rare occurrence in the statements of insurance companies and their treatment of non-admitted assets works no great hardship. Banks make loans on personal security and such loans, if not in default, are considered as good assets. However, it is a part of a bank's business to make loans to individuals whereas this function is not necessary to the operation of an insurance company.

Item 51—"Deposits in suspended banks, less $——— estimated amount recoverable"

This item is a result of the "depression" and was introduced in the blank in 1931. It is self-explanatory and is of little consequence at the present time.

Items 52-53A—Book value of ledger assets over market value—Real estate, bonds and stocks

These items are the reverse of Items 39-40A. If the book value exceeds the market value (or amortized value, in case of bonds) the excess is treated as a non-admitted asset.

In computing the excess of market values of the various ledger assets over the corresponding book values the excesses for each particular asset are "net" and not "gross." If a company owned five pieces of real estate, on three of which the market value exceeded the book value and on the other two the book value exceeded the market value, the net excess would be entered in either Item 39 or Item 52.

As pointed out on page 305, increases (or decreases) by adjustment of ledger assets are unnecessary so far as the effects of changes in security values upon surplus are concerned, since such changes in surplus are automatically reflected in Items 40 and 40A or 53 and 53A, Page 4. A simple example will illustrate. Assume that a bond carried upon the books at $990 has a market value of $1,000. If an increase by adjustment is made, the effect upon the statement is as follows:

Increase by adjustment............	$10.00	(Increase in surplus)
Increase in ledger assets...........	10.00	
Market value of bonds over book value	0	
Increase in gross assets............	10.00	
Increase in admitted assets.........	10.00	

If the increase by adjustment is not made, the effect upon the statement is as follows:

Increase by adjustment............	0	
Increase in ledger assets...........	0	
Market value of bonds over book value	$10.00	(Increase in surplus)
Increase in gross assets............	10.00	
Increase in admitted assets.........	10.00	

Item 53B—"Interest due and accrued on mortgage loans (state basis)"

This is also a "depression" item, incorporated in all statement blanks in 1936 because of the considerable number of loans on which interest became in default. It is of greater importance in the case of life companies than in the case of casualty companies, since the latter as a rule do not invest extensively in mortgage loans. Its purpose, as indicated, is to provide for the deduction as a non-admitted asset of any interest due and accrued, included in Item 33, which may reasonably be assumed to be uncollectible. No specific rules for computing such deduction are in effect, but it is obvious that a conservative policy should be adopted.

Items 54-57—"Other assets not admitted, viz:"

These lines are to provide for the excesses of book over market values of any ledger assets not specifically provided for and for any other non-admitted assets.

Item 58—"Total Admitted Assets"

This item is the difference between Item 44 and the extended amount of Item 57.

SECTION V—LIABILITIES (Page 5)

(See Exhibit 4, Page 324)

With the exception of "Capital," "Borrowed money," "Funds held under reinsurance treaties" and a few other unimportant ledger liabilities the various items of liabilities are not taken from the books of account but are determined by inventory and formula methods. The most important items are the claim and unearned premium reserves, which usually account for from 80% to 85% of the total liabilities excluding capital. In addition to the claim and unearned premium reserves specific provision is made for liabilities or reserves for claim expense, commissions due or to become due, salaries and other expenses due or accrued, taxes due or accrued, declared and unpaid dividends, interest due or accrued including interest on borrowed money.

It seems unnecessary to comment upon each individual item of this section, and to attempt to describe the methods, formulae and accounting practices prescribed for or adopted by the companies is beyond the scope of this paper.

The difference between the "Total Admitted Assets," Item 58, Page 4, and the sum of "Total amount of all liabilities, except capital," Item 48, and "Capital paid up," Item 49, produces the "Surplus over all liabilities," or company surplus, Item 50.

Item 51, the sum of Items 49 and 50, is designated as the "Surplus as regards policyholders."

Item 52, "Total," is the sum of Items 48 and 51 and, as indicated, balances with Item 58, Page 4.

EXHIBIT 4

Form 3 ANNUAL STATEMENT FOR THE YEAR 1940 OF THE ________________ 5
(*Write or stamp name of Company*)

V—LIABILITIES

DOLLARS | CENTS

1. Losses and claims:	(1) Adjusted or in process of adjustment	(2) Resisted	(3) Deduct reinsurance per Schedule E column (2)	(4) Net unpaid claims excluding incurred but not reported	(5) Incurred but not reported	(6) Total net unpaid claims except liability and workmen's compensation claims (excluding expenses of investigation and adjustment)
2. Accident						(d)
3. Health						(d)
4. (c) Non-cancellable accident and health						(d)
5. Fidelity						
6. Surety						
7. Plate glass						
8. Burglary and theft						
9. Steam boiler						
10. Machinery						
11. Auto property damage						
12. Auto collision						
13. Property damage and coll. other than auto						
14. (a)______						
15. TOTALS						

16. Reserve for unpaid liability losses . . . . $________
and workmen's compensation losses . . . . ________ $________

17. Reserve for credit losses on policies expiring in October, November and December of current year, being fifty per cent of $________, gross premiums received on said policies, less $________ paid on losses under said policies . . . . ________

18. Reserve for accrued losses on credit policies in force December 31 of current year, being fifty per cent of $________ earned premiums on said policies, less $________ paid on losses under said policies . ________

19. Total unpaid claims . . . .

20. Estimated expenses of investigation and adjustment of unpaid claims:

21. Accident $________; Health $________; Non-cancellable accident and health $________; Fidelity $________;

22. Surety $________; Plate glass $________; Burglary and theft $________; Steam boiler $________;

23. Machinery $________; Auto prop. damage $________; Auto collision $________; Property damage and collision other than auto $________;

24. (b)________ $________; ________ $________; ________ $________; ________ $________;

25. Total unearned premiums as shown by recapitulation, page 7. . . . .

25½ (c) Additional reserve on non-cancellable accident and health policies $________, less $________ reserve on policies reinsured

26. Commissions, brokerage and other charges due or to become due to agents or brokers on policies effective on or after October 1, of current year, viz:

27. Accident $________; Health $________; Non-cancellable accident and health $________; Auto liability $________;

28. Liability other than auto $________; Workmen's compensation $________; Fidelity $________; Surety $________;

29. Plate glass $________; Burglary and theft $________; Steam boiler $________; Machinery $________;

30. Auto prop. damage $________; Auto collision $________; Property damage and collision other than auto $________; (b)________ $________;

31. Salaries, rents, expenses, bills, accounts, fees, etc., due or accrued . . . .

32. Estimated amount due or accrued for taxes . . . .

33. Dividends declared and unpaid to stockholders, $________, to policyholders, $________ . . . .

34. Due and to become due for borrowed money . . . .

35. Interest due or accrued including $________ on borrowed money . . . .

36. Funds held under reinsurance treaties . . . .

37. Other liabilities, viz:

38. ____ $________

39. ____ ________

40. ____ ________

41. ____ ________

42. ____ ________

43. ____ ________

44. ____ ________

45. ____ ________

46. ____ ________

47. ____ ________

48. Total amount of all liabilities, except capital . . . .

49. *Capital paid up . . . . $________

50. Surplus over all liabilities . . . . ________

51. Surplus as regards policyholders . . . .

52. **Total** . . . .

(a) Enter "Credit (on policies expiring prior to October of current year)," or other lines of business.
(b) Enter lines of business.
(c) State reserve basis and describe methods used.
(d) Including $________ for present value of life indemnity claims.
*Mutual Companies to enter here the amount of guaranty or other permanently designated funds with appropriate description.

UNDERWRITING AND INVESTMENT EXHIBIT

(See Exhibit 5, Pages 326 and 327)

The underwriting and investment exhibit corresponds to what is designated in general commercial accounting as the "Profit and Loss" account. In this exhibit the statement is transformed (in summary form) from a "cash" to a "revenue" basis and, in addition, shows the gains or losses from various sources and the disposition thereof. The exhibit is divided into three main parts as follows:

(1) Underwriting exhibit
(2) Investment exhibit
(3) Miscellaneous exhibit

The various subdivisions of Part (1) arranged in debit and credit order are:

	Debit		Credit
Premiums earned	..		X
Losses incurred	X		..
Loss adjustment expenses incurred	X		..
Underwriting expenses incurred	X		..
Underwriting profit and loss items	X	or	X

The net balance (Item 41) of the foregoing produces the net gain or loss from underwriting, including underwriting profit and loss.

The various subdivisions of Part (2) arranged in debit and credit order are:

	Debit	Credit
Interest and rents earned	..	X
Investment expenses incurred	X	..
Profit on investments	..	X
Loss on investments	X	..

The net balance (Item 68) of the foregoing produces the net gain or loss on investments, including investment profit and loss.

The various subdivisions of Part (3) arranged in debit and credit order are:

	Debit		Credit
Dividends declared to stockholders	X		..
Dividends declared to policyholders	X		..
Remittances from home office	..		X
Remittances to home office	X		..
Increase (or decrease) in special reserves	X	or	X
(Gain or loss) from other sources	X	or	X

The net balance (Item 78) of the foregoing produces the net

EXHIBIT 5

8 ANNUAL STATEMENT FOR THE YEAR 1940 OF THE ______________________ Form 3
(*Write or stamp name of Company*)

UNDERWRITING AND INVESTMENT EXHIBIT

Showing the Sources of the Increase and Decrease in Surplus During the Year

UNDERWRITING EXHIBIT				Gain in Surplus	Loss in Surplus
PREMIUMS					
1. Total premiums, per item 20, page 2					
2. Add unearned premiums and additional reserve December 31 of previous year, per item 4 of last year's exhibit					
3. Total					
4. Deduct unearned premiums and additional reserve Dec. 31 of current year, per items 25 and 25½, page 5					
5. **Premiums earned during the year**					
LOSSES					
6. Losses paid, per item 17, page 3					
7. Add salvage and reinsurance recoverable December 31 of previous year, per item 9 of last year's exhibit					
8. Total					
9. Deduct salvage and reinsurance recoverable December 31 of current year, per items (a)__________, page 4					
10. Balance					
11. Add unpaid losses December 31 of current year, per item 19, page 5					
12. Total					
13. Deduct unpaid losses December 31 of previous year, per item 11 of last year's exhibit					
14. **Losses incurred during the year**					
LOSS ADJUSTMENT EXPENSES					
15. Loss adjustment expenses paid during the year, per item 24, page 3					
16. Add loss adjustment expenses unpaid December 31 of current year, per item 24, page 5					
17. Total					
18. Deduct loss adjustment expenses unpaid December 31 of previous year, per item 16 of last year's exhibit					
19. **Loss adjustment expenses incurred during the year**					
UNDERWRITING EXPENSES					
20. (c) Underwriting expenses paid during the year, per disbursement exhibit, page 3					
21. (a) Add underwriting expenses unpaid December 31 of current year, per liabilities exhibit, page 5, viz:—					
22. Total					
23. Deduct underwriting expenses unpaid December 31 of previous year, per item 21 of last year's exhibit					
24. **Underwriting expenses incurred during the year**					
25. **Underwriting losses and expenses**					
26. (b)__________ **from underwriting during the year**					
UNDERWRITING PROFIT AND LOSS ITEMS					
27. Gain from:					
28. Inspections, per item 21, page 2					
29. Agents' balances previously charged off, per item 37, page 2					
30. Other underwriting income, per income exhibit, page 2(a)					
31. Total					
32. Loss from:					
33. Agents' balances charged off, per item 59, page 3					
34. Other underwriting disbursements, per disbursement exhibit, page 3, other than losses and expenses, per items 6, 15 and 20 of this exhibit (a)__________					
35. Total					
36. (b)__________ from items 27 to 35					
37. Bills receivable and premiums in course of collection not admitted December 31 of previous year, per item 38 of last year's exhibit . . $					
38. Bills receivable and premiums in course of collection not admitted December 31 of current year, per items 48 and 49, page 4 . . $					
39. (b)__________ from items 37 and 38					
40. (b)__________ **from profit and loss items**					
41. (b)__________ **from underwriting and profit and loss items during the year** (carried forward)					

(a) Give statement number of each item or portion thereof included herein
(b) Write "Gain" or "Loss".
(c) In order to secure uniformity in the reports of the various companies, all companies are directed to include in this item all disbursements, except payments to policyholders, per item 17, page 3; agents' balances charged off, in item 59, page 3; loss adjustment expenses; repairs, expenses and taxes on real estate; such other taxes and fees as apply to investments and personal property only; dividends to stockholders; loss on sale or maturity and decrease in book value of ledger assets, and such other items, if any, as are known to apply exclusively to the assets of the company, and to deduct from the total of said items as investment expenses one-eighth of one per cent. of the mean invested assets, viz: Real estate owned, mortgage loans, collateral loans and stocks and bonds owned.

EXHIBIT 5—Continued

Form 3 ANNUAL STATEMENT FOR THE YEAR 1940 OF THE ______________________________ 9
(*Write or stamp name of Company*)

No.	INVESTMENT EXHIBIT				GAIN IN SURPLUS	LOSS IN SURPLUS
42.	Brought forward					
	INTEREST AND RENTS					
43.	Interest, dividends and rents received during the year, per item 30, page 2, less item 58, page 3, and less $........amortization and plus $........accrual					
44.	Deduct interest, dividends and rents due and accrued December 31 of previous year, per item 46 of last year's exhibit					
45.	Balance					
46.	Add interest, dividends and rents due and accrued December 31 of current year, per item 38, page 4, less the sum of item 35, page 5, and item 53B, page 4 .					
47.	Add interest and rents paid in advance December 31 of previous year, per item 49 of last year's exhibit .					
48.	Total					
49.	Deduct interest and rents paid in advance December 31 of current year, per liability exhibit, page 5 . .					
50.	**Gross interest, dividends and rents earned during the year**					
	INVESTMENT EXPENSES					
51.	(d) Investment expenses paid during the year, per disbursement exhibit, page 3. (Attach exhibit)..........					
	....					
	....					
52.	Deduct investment expenses unpaid December 31 of previous year, per item 54 of last year's exhibit .					
53.	Balance					
54.	(a) Add investment expenses unpaid December 31 of current year, per liabilities exhibit, page 5, viz:—....					
	....					
55.	**Investment expenses incurred during the year** .					
56.	**Net interest, dividends and rents earned during the year**					
	PROFIT ON INVESTMENTS					
57.	Gain from sale of ledger assets, per item 38, page 2 .					
58.	Gain from increase in book value of ledger assets, other than for accruals, per item 39, page 2 . . .					
59.	Gain from change in difference between book and market value during the year					
60.	Gain from other investments, viz:—(Give items and amounts)....................................					
61.	**Profit on investments during the year** . . .					
	LOSS ON INVESTMENTS					
62.	Loss from sale of ledger assets, per item 60, page 3 .					
63.	Loss from decrease in book value of ledger assets, other than for amortization, per item 61, page 3 . .					
64.	Loss from change in difference between book and market value during the year.					
65.	Loss from other investments, viz:—(Give items and amounts)....................................					
66.	**Loss on investments during the year** . . .					
67.	(b)..................**from investment profit and loss items**					
68.	(b)..................**from investments during the year** .					
69.	Total gains and losses from underwriting and investments					

No.	MISCELLANEOUS EXHIBIT	GAIN IN SURPLUS	LOSS IN SURPLUS	GAIN IN SURPLUS	LOSS IN SURPLUS
70.	Dividends declared to stockholders during the year				
71.	Dividends declared to policyholders during the year				
72.	Remittances from home office (gross)				
73.	Remittances to home office (gross)				
74.	..........crease in special reserves				
75.	(a), (b)......................from other sources:				
76.	....				
77.	....				
78.	Net (b)..............................from items 70-77				
79.	Total gains and losses in surplus during the year				
80.	Surplus December 31 of previous year, per item 81 of last year's exhibit				
81.	Surplus December 31 of current year, per item 50, page 5				
82.	..........**crease in surplus during the year** (enter in column to balance)				
83.	Totals				
84.	Per cent. of losses incurred to premiums earned..............................				
85.	Per cent. of loss adjustment expenses incurred to premiums earned..............................				
86.	Per cent. of underwriting expenses incurred to premiums earned..............................				
87.	Per cent. of investment expenses incurred to gross interest and rents earned..............................				

(a) Give statement number of each item or portion thereof included herein.
(b) Write "Gain" or "Loss".
(d) Include in this item one-eighth of one per cent. of the mean invested assets; repairs, expenses and taxes on real estate; such other taxes and fees as apply to investments and personal property only; and such other items, if any, as are known to apply exclusively to the assets of the company.

gain or loss in surplus from miscellaneous sources after deduction of dividends to stockholders (and/or policyholders) and special reserve adjustments.

The algebraic sum (+ = credit balance or gain; — = debit balance or loss) of the net balances of the three subdivisions produces the net increase or decrease in surplus during the year—Item 82.

The various items of the underwriting and investment exhibit are all obtainable from Sections I-V of the current year's annual statement and Sections IV, V and the underwriting and investment exhibit of the previous year's statement. It should be pointed out that in arriving at the investment expenses paid during the year it is arbitrarily assumed—see footnote (d), Page 9 of statement—that a portion of general expense equal to ⅛ of 1% of mean invested assets (Items 1-4, Page 4 of statement) is chargeable to investments in addition to all specific investment expense. In order to preserve the statement balance, this arbitrary amount is deducted from underwriting expenses paid (Item 20, Page 8 of statement).

The earned income and incurred losses and expenses are determined from the cash income, cash disbursements, non-ledger assets, non-admitted assets and non-ledger liabilities by means of the following basic formulae:

Earned Income

(1) To: Cash income (net)
(2) Add: The current year's non-ledger asset
(3) Add: The previous year's non-ledger liability (or liabilities)
(4) Deduct: The previous year's non-ledger asset
(5) Deduct: The current year's non-ledger liability (or liabilities)
(6) Balance = Earned income

The foregoing formula applies to the subsections headed Premiums and Interest and Rents.

Incurred Losses and Expenses

(1) To: Cash disbursements
(2) Add: The current year's non-ledger liability (or liabilities)

(3) Add: The previous year's non-ledger asset
(4) Deduct: The previous year's non-ledger liability (or liabilities)
(5) Deduct: The current year's non-ledger asset
(6) Balance = Incurred losses (or expenses)

The foregoing formula applies to the subsections headed Losses, Loss Adjustment Expenses, Underwriting Expenses and Investment Expenses.

The above formulae are inclusive so to speak. For example, in determining earned premiums (first formula) only Items (1), (3) and (5) are used in most instances as Items (2) and (4) are usually "O". Similarly, in determining incurred expenses (second formula) only Items (1), (2) and (4) are used in most instances as Items (3) and (5) are usually "O".

The items included in Lines 27-35, Page 8 of statement and Lines 57, 58, 62, 63, 72 and 73, Page 9 of statement, do not involve non-ledger items but are taken direct from the income or disbursement pages.

Gains or losses involving only non-ledger assets, non-admitted assets, or non-ledger liabilities and not income and disbursements are determined by taking the differences between such items in the current and previous year's statements. These include the following:—Item 39, Page 8 of statement, and Items 59 or 64, 60 or 65 and 74, Page 9 of statement.

In the case of companies which value their bonds on the amortization basis, the net amount of the increases for accrual of discount and the decreases for amortization of premiums is reported as interest in Item 43, Page 9 of statement instead of in Items 58 and 63 respectively. This procedure is in harmony with the theory of valuation on the amortized basis, since the effective interest and not the nominal interest should be credited to interest account.

Conclusion

The revised paper is intended, as was the original paper, to serve merely as an introduction to the subject of casualty insurance bookkeeping and accounting and as a necessarily limited exposition of the requirements of the financial section and the underwriting and investment exhibit of the casualty annual statement blank. As stated in the writer's review of the discussion of the original paper, "the paper was prepared primarily for students of our Society engaged in statistical and actuarial work and having some text-book knowledge of bookkeeping and accounting but little, if any, contact with the company books of account. The paper was intended to show briefly the rationale of the annual statement and the application of bookkeeping and accounting principles to the various insurance accounts."

It is the intention of the writer to present at a subsequent meeting a revision of the original supplemental paper, "Exhibits and Schedules of the Casualty Annual Statement Blank, *Proceedings,* Vol. XVI, Part I."

Since the original paper was presented, additional texts and papers bearing upon the subject of casualty insurance accounting in general and certain specialized phases thereof have been published. For purposes of ready reference, the following bibliography, including previous and subsequent material, is submitted:

Hull, R. S.: Casualty Insurance Accounting.

Michelbacher, G. F. and Associates: Casualty Insurance Principles. Chapter 19.

Bailey, W. B.: The Allocation of Adjusting Expense to Line of Insurance. P.C.A.S. XIV, 233.

Perryman, F. S.: The Theory of the Distribution of the Expenses of Casualty Insurance. P.C.A.S. XVII, 22.

Waite, H. V.: Distribution of Inspection Cost by Line of Insurance. P.C.A.S. XXII, 15.

Tarbell, T. F. and Waite, H. V.: The Distribution of Casualty Administration Expense by Line of Insurance. P.C.A.S. XXIV, 45.

Report of Committee on Uniform Method of Expense Distribution (New York Casualty Experience Exhibit). Association of Casualty and Surety Accountants and Statisticians.