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Accounting for the Investment Credit

United States. Securities and Exchange Commission

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SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

SECURITIES ACT OF 1933
Release No. 4574
SECURITIES EXCHANGE ACT OF 1934
Release No. 6990
HOLDING COMPANY ACT OF 1935
Release No. 14787
INVESTMENT COMPANY ACT OF 1940
Release No. 3611
ACCOUNTING SERIES
Release No. 96

ACCOUNTING FOR THE "INVESTMENT CREDIT"

In view of the extensive public discussion of the accounting for the investment credit provided in the Revenue Act of 1962 and the fact that the Accounting Principles Board of the American Institute of Certified Public Accountants has concluded that the investment credit should be reflected in income over the productive life of acquired property, 1/ the Securities and Exchange Commission deems it appropriate to respond to inquiries with respect to the application of the Commission's accounting and disclosure requirements to this matter.

In Accounting Series Release No. 1, published April 1, 1937, the Commission announced a program for the purpose of contributing to the development of uniform standards and practice in major accounting questions. Accounting Series Release No. 4 recognizes that there may be sincere differences of opinion between the Commission and the registrant as to the proper principles of accounting to be followed in a given situation and indicates that, as a matter of policy, disclosure in the accountant's certificate and footnotes will be accepted in lieu of conformance to the Commission's views only if such disclosure is adequate and the points involved are such that there is substantial authoritative support for the practice followed by the registrant, and then only if the position of the Commission has not been expressed previously in rules, regulations, or other official releases of the Commission, including the published opinions of its Chief Accountant. This policy is intended to support the development of accounting principles and methods of presentation by the profession but to leave the Commission free to obtain the information and disclosure contemplated by the securities laws and conformance with accounting principles which have gained general acceptance.

In recognition of the substantial diversity of opinion which exists among responsible persons in the matter of accounting for the investment credit, the Commission will accept either a method which reflects the investment credit in income over the productive life of the acquired property or a method which reflects 48% of the investment credit (the

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1/ Opinion No. 2, Accounting for the "Investment Credit."

maximum extent to which the credit can normally increase net income) in income as a reduction of the tax expense of the year in which the credit arises and defers the balance of 52% to subsequent accounting periods during which depreciation allowances for tax purposes are reduced because the statutory requirement reduces the basis of the property for tax purposes by the amount of the investment credit. The amount of such deferral should be segregated from taxes currently payable. The 100% flow-through to income of the investment credit benefit in the year in which it arises will be accepted in the case of regulated industries when authorized or required by regulatory authorities. In all cases full disclosure of the method of accounting followed and amounts involved should be made where material.

In any case it is the Commission's opinion that the full cost of the property should be reported and that the credit should not be made directly to the asset account. Income tax expense should not be stated in excess of the amount payable for the year. No objection will be taken to the recording of additional depreciation equal to the amount of the deferral arising from the above methods of accounting for the investment credit. The amounts involved should be segregated at least in the appropriate notes and schedules required by our accounting regulations.

The certification rules of the Commission require that the accountant's certificate shall state clearly the opinion of the accountant in respect of the financial statements covered by the certificate and the accounting principles and practices reflected therein. The term "accounting principles and practices" should be read in the light of the discussion of broad principles and practices in the booklet "Audits of Corporate Accounts," 2/ which was recognized as a significant guide to the profession at the time of drafting our original accounting and certification requirements.

2/ This booklet consists of a series of letters passing between the Institute's special committee on cooperation with stock exchanges and the committee on stock list of the New York Stock Exchange during the years 1932-1934 with a view to making the accounts published by corporations more informative. This endeavor resulted in the demonstration that certain accounting principles were so generally accepted that they should be followed by all listed companies, the adoption of these principles as rules by the American Institute of Accountants membership, the requirement by the New York Stock Exchange that certified financial statements be included in all listing applications, and the development of an accountant's certificate which would be more informative and more clearly understood by investors and which is substantially the same as the certificate in general use today.

A note to the booklet states that a letter expressing the recommendations of the American Institute of Accountants committee was placed in evidence "in a hearing before the United States senate committee on banking and currency January 12, 1933."

It is recognized that an accountant who certifies to financial statements reflecting a method of reporting contrary to the majority opinion of the Accounting Principles Board is assuming the burden of justifying departure from the recommended procedure and must take into consideration whether he is departing from an accepted procedure and consequently whether he must qualify his certificate with respect to the fairness of the presentation in the financial statements or to a departure from generally accepted accounting principles and practices. In the usual case where an accountant takes exception to a principle or practice followed, the amount involved is material. In view of the substantial diversity of opinion as to the proper method of accounting for the investment credit, if an accountant deems it necessary to qualify his opinion under various circumstances the Commission will accept certificates containing appropriately worded qualifications in accordance with Rule 2-02 (d) of Regulation S-X when an alternative accounting treatment acceptable to the Commission is followed by the registrant.

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