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Uniformity in Accounting
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THERE is a lot of loose talk today about uniformity in accounting. Much of it is related to the investor's understandable desire to make meaningful comparisons between financial statements of different companies. Some accountants seem to think that uniformity is essential to the accounting process because it creates comparability. Other accountants seem to think that uniformity is a bad thing because it would eliminate all alternatives in accounting. It is not clear what the two sides mean by uniformity. At what levels of accounting is uniformity proposed; at what levels is it opposed? As frequently happens, the arguments are made on one extreme or the other and many of us see merit in the arguments of each side. The result is that we are confused and do not know what position to take.

My purpose tonight is to analyze the uniformity issue and give you my appraisal of what the profession should do about it.

THE PROBLEM

A logical starting point is to define uniformity. Dictionary definitions cannot always be applied directly to technical areas. Nevertheless, we are dealing with a common word that is familiar to accountants and non-accountants.

Two dictionary definitions seem particularly to fit our discussion: "conforming to one rule" and "absence of variation." Putting these two definitions together and relating them to accounting, a working definition of uniformity in accounting might be "accounting for a given transaction should conform to one rule and there should be no variation in the results."

Before going further, consider why we do not have uniformity today. This is not the first time the question has been considered. As early as the 1930s, the uniformity approach was rejected by special committees of the AICPA and the New York Stock Exchange. At that time those two bodies agreed that a realistic goal of accounting was "to make universal the acceptance by listed corporations of certain broad principles of accounting which have won fairly general acceptance, and within the limits of such broad principles to make no
attempt to restrict the right of corporations to select detailed methods of accounting deemed by them to be best adapted to the requirements of their business. ...” (emphasis added)

Since that time, the consistent and official objective of the American Institute through the Committee on Accounting Procedure and the Accounting Principles Board has been to narrow the areas of difference and inconsistency in practice, but not necessarily to eliminate them entirely.

The Securities and Exchange Commission is also working toward the elimination of alternatives but it recognizes that complete uniformity is not possible.

The Internal Revenue Service recognizes differences in accounting methods for income tax purposes; some such differences are authorized in the Internal Revenue Code.

The Federal Power Commission and other regulatory authorities have attempted to attain uniformity in accounting by the promulgation of uniform systems of accounts. Nevertheless, many, perhaps all, of these uniform systems contain provisions for alternative methods of accounting.

Historically, accounting principles and methods have evolved through practice, and differences in methods have not been condemned per se. In view of this, it is rather surprising and a credit to the accounting profession, and also to others, that we have as much uniformity in accounting as we have.

The rules that govern accounting may be considered at two levels:

1. Principles, assumptions, and conventions
2. Methods, practices, and procedures

Principles, assumptions, and conventions form the framework on which accounting rests; they are few in number and generally do not vary with circumstances within a company.

Methods, practices, and procedures flow from and make application of principles, assumptions, and conventions. Generally they vary with and depend on circumstances within a company.

PRINCIPLES, ASSUMPTIONS, AND CONVENTIONS

Let me first discuss uniformity at the level of principles, assumptions, and conventions.

I hasten to say that I have no authority for establishing what is to be included at this level—the Accounting Principles Board will ultimately do that for us. I believe you will agree, however, that
the items I shall list are worthy of being included among the basic principles, assumptions, and conventions on which our current accounting system has been developed.

As I mention these, have in mind the uniformity with which they are observed.

Accounting entities—accounting is conducted for specific entities.
Accounting period—accounting reports are prepared for uniform periods of time.
Accrual basis—income should be recorded in period earned or realized; expenses should be recorded in the period incurred.
Conservatism—lean to the safe side, avoid positive error, an understatement is better than an overstatement of an asset, etc.
Consistency—accounting methods should be consistently followed by a given company through periods of time.
Cost—assets are accounted for on the basis of acquisition costs measured in cash or its equivalent (in some cases, reduced to market).
Going concern—it is assumed that the accounting entity will continue in operation indefinitely.
Informative disclosure—financial statements should disclose all information necessary to make the statements not misleading.
Matching costs and revenues.
Materiality—items of little or no consequence may be dealt with as expediency may suggest.
Objectivity—to the extent practicable, accounting should be based on objectively determined data.
Realization—income should not be recorded until it is realized.
Stable measuring unit—the dollar is assumed to be a stable measuring unit.

The assumption of a stable measuring unit is generally considered to be invalid; nevertheless, the assumption is uniformly applied.
The cost convention is almost universally applied; but we are beginning to see exceptions—investment companies, for example.
The principle of matching costs and revenues must frequently yield to problems of objectivity. You cannot match what you cannot measure—the cost of advertising that will produce future revenue, for example.
The conventions of conservatism and materiality may be uniformly
applied but, by nature, they do not necessarily produce uniform results. In application, each of these must be envisioned as incorporating a range of acceptability, not a point of acceptability.

The convention of conservatism is worthy of further comment. Financial statements are the representations of management, and there are wide variations in management conservatism. There are many areas in which the conservatism of management can affect an income statement or a statement of financial position: depreciation lives and methods, capitalization and expense policies, provisions for bad debts, deferral of research and development costs, and provisions for pensions, to name a few. The effect of conservatism on decisions in matters such as these can have a material effect; yet within reasonable limits no one can say that management's decisions are "wrong" or that the financial statements do not "fairly present." Within these limits, each company's financial statements should reflect the degree of conservatism of its own management. Otherwise management is relieved of its responsibility for financial reporting.

In summary, at the level of principles, assumptions and conventions, I think we should have uniformity of application. However, we should realize that uniformity of application will not necessarily produce uniformity of results.

METHODS, PRACTICES, AND PROCEDURES

Turning now to the level of methods, practices and procedures, let me indicate what I consider to be the basic causes of the differences that exist today:

First, and most important—circumstances
Second—differences between form and substance
Third—the absence of accepted principles applicable in many circumstances, or the questionable validity of principles that are generally accepted

CIRCUMSTANCES

Different accounting methods, practices and procedures result from differences in circumstances. Circumstances vary, depending on such factors as industry, type of product, nature of operations, business policies, type and use of assets, areas of operations, organizational structure, tax considerations, and the judgment of management.

Variations in these circumstances have given rise to different methods of accounting for inventories, depreciation, the deferral of
various expenditures, intangibles, long-term contracts, investments, and so on.

I shall not dwell on all of these circumstances or methods but I should like to say a few words about tax considerations and judgment of management.

**Tax Considerations**

In referring to tax considerations, I have two subjects in mind: the LIFO inventory method and the adoption of book depreciation rates to conform to tax depreciation rates.

Although there are theoretical arguments for the LIFO inventory method, the basic circumstances that have resulted in its widespread use are its allowance for income tax purposes and the tax requirement that it be recorded on the books. Frankly, I have difficulty saying that this is a valid circumstance from a theoretical accounting point of view. However, to deny the use of LIFO is to create substantial tax liabilities for many companies. This would be harmful to the company, its management, and stockholders, possibly to employees and creditors. In the face of a situation like this, I think we have no practicable alternative to disclosure of the use of the method.

As to the use of tax depreciation rates for book purposes, we have a different problem. Historically, there has been a battle to get enough depreciation for tax purposes. Now we have accelerated methods of depreciation and Guideline lives. Many companies have continued using their book lives and have recorded deferred taxes applicable to any excess of tax depreciation over book depreciation. Other companies have changed their book rates to the higher tax rates. Does the use of depreciation rates for tax purposes justify the use of the same rates for book purposes? In practice it has been accepted as justification, and the effect is frequently quite material. Here we have a tough problem. Frankly, I do not know the answer. I do think that the matter of depreciation has not received sufficient attention from the accounting profession.

**Judgment of Management**

The final circumstance I listed was judgment of management. Some might question whether judgment of management is a circumstance; but whatever you may wish to call it, it is probably the most essential ingredient of all. It is management's judgment that sets depreciation rates; bad-debt reserves; provisions for losses; deferrals
of research and development expense; amortization of intangibles, and so on.

These are obvious examples. I want to make a more important point: It is management's appraisal of circumstances that governs the selection of accounting methods, practices and procedures. It is not the circumstances themselves, it is management's appraisal of the circumstances that governs.

Circumstances do not always point in the same direction. Some point toward one conclusion; others point toward another conclusion. It is management's function to weigh all of the circumstances and to decide on the accounting that best fits all of them.

For example, assume two companies buy identical machines for the same purpose and to be used in the same manner. Further assume that the two managements each estimate their machines will last the same number of years and have the same salvage value. Also each management believes that production from this machine will be somewhat higher in the earlier years than in the later years if demand drops off. However, if they get a good reception when their product is introduced, production should hold steady for the life of the machine. On these facts, the management of one company decides to use straight-line depreciation and the management of the other company decides to use declining-balance depreciation.

Where is the difference in circumstances? The answer of course is that the managements differed in how they weighed the facts. Neither management should be forced to abandon his decision in favor of the other. If either were to do so, the financial statements of his company would not then be the representation of his best judgment and would not reflect an important circumstance.

In addition, circumstances change during the course of the progress of a business. It is the function of management to reappraise circumstances from time to time and, if necessary, to change their accounting accordingly.

For example, consider a small company spending relatively large amounts on research and development. If it charges these expenditures to expense as incurred, it will show a loss, perhaps a deficit, perhaps even a capital deficiency. The fact may be that it has developed products of substantial value, which are expected to be quite profitable. Under these circumstances, the company should use the deferral method of accounting for research and development expenditures.

The years pass, the company grows and prospers. Its research and development program has grown too but it is now spending about
the same amount each year. Some of its expenditures result in mar­ketable products and others do not. It has become increasingly diffi­cult to measure the future benefits. Management recognizes a change in circumstances and decides to change to the charge-off method. This company has progressed from circumstances where one method was preferable to circumstances where another was preferable.

The change did not occur at an instant of time. It was a proper and necessary function of management to appraise the circumstances and to select the method it considered most appropriate.

In summary as to circumstances, I think variations in accounting methods, practices, and procedures must be provided to fit variations in circumstances. At the same time, the different methods should be used only in the appropriate circumstances.

FORM AND SUBSTANCE

The second basic cause that I listed for differences in accounting methods, practices, and procedures concerns the distinction between form and substance. Obviously, the determination of form and sub­stance depends in part on circumstances. However, I consider these problems to be sufficiently different to be taken up as a separate group.

First, to define the problem area, I am talking about a transaction that takes a particular form—for example, a lease—but in substance is something else—a purchase. Of course, the accounting for property under lease is different from the accounting for property owned.

I think most of us would agree generally that accounting should reflect the substance of economic facts and not merely their form. On the other hand, accounting for a transaction as if it had been another transaction may be misleading because it reflects what might have been rather than what was. Furthermore, such "as-if" accounting could have important legal implications. (Effects on taxes, loan agree­ments, and borrowing capacity are to be considered, for example).

The primary thing that makes problems of form and substance different from most accounting problems is that accounting for the substance sometimes constitutes a repudiation of the form. Since the company selects the form, this frequently puts the accountant in a position contrary to his client's.

Sometimes form is selected for legal, tax, or operating reasons. However, sometimes form may be selected to avoid the recording of a liability, to avoid the recording of acquisition values, or to effect the recording of unrealized gains.

This type of problem is familiar to all of us; examples are:
consolidated or parent company financial statements, lease-receivable or property accounting, sales and leasebacks, leases or purchases, stock dividends or stock split-ups, poolings-of-interests, or purchases.

The accounting is usually simple in these cases after it is decided what the transaction is. That decision is made difficult, however, by the many possible variations. Usually the extremes are clear; the clouds descend as you approach the middle. You frequently reach the point where the distinctions can rest on minor points, yet the accounting consequences can be substantial.

We need to achieve greater uniformity and comparability in these areas. I have almost no hope that all differences can be eliminated, but I do think that we should develop some sound guidelines.

**ABSENCE OF ACCEPTED PRINCIPLES**

The final major cause that I listed for differences in accounting methods, practices, and procedures is the absence of accepted principles applicable in many circumstances, or the questionable validity of principles that are generally accepted.

We all know that a complete set of generally accepted accounting principles does not exist. Because of this, there have not been underlying rules to govern some types of transactions. In this atmosphere it is natural that different concepts should develop and different accounting methods, practices, and procedures should flow from them.

The only way to eliminate some of these differences is to develop basic principles that will become generally accepted. A discussion of the principles needed could go on almost without end. I shall mention only three. They are in the areas of:

1. **Liabilities**
2. **Income**
3. **Value and changing price levels.**

**Liabilities**

So far as I am aware, there is no definitive accounting principle dealing with liabilities. In the absence of one, we are left with different concepts that lead to different answers to our problems. For example, when must a liability be recorded—

- When it is legally enforceable (bonds)?
- When it will become legally enforceable merely through the passage of time (accrued payrolls)?
- When it is reasonable to expect that it will be paid if presen...
conditions continue unchanged (pension benefits; deferred in-
come taxes)?

In addition we need principles to establish the amount of the
liability. For example, should it be the face amount, a discounted
amount, or some other amount?

Until we get principles in these areas we shall continue to have
differences in accounting for pension costs, deferred income taxes and
defered compensation plans. Essentially these are one problem not
three.

Income

The determination and presentation of income is another trouble-
some area.

For one thing, we have the old current-operating versus the all-
inclusive approach to the income statement. Oddly enough, today's
diverse practice may have resulted in part from the firm position of
the Committee on Accounting Procedure that one figure should clearly
be labeled "net income." Where extraordinary or prior year items
exist, it may be preferable that no "net income" appear as such and
that the "before" and "after" approach be taken. Certainly this
would force the attention of the reader to the different types of income
in the statement.

Another troublesome area is income equalization. I grew up
thinking that income equalization was bad; apparently it is not con-
sidered so anymore. At least, the spreading treatment of the invest-
ment credit can be looked on as a form of income equalization; so can
many of the other income tax allocations being made today.

There is a definite need for principles in these areas of income
determination.

Value and Price-Level Adjustments

Turning now to the question of value and price-level adjustments,
we have problems that arise from principles of questionable validity;
that is, the assumption of a stable dollar and the cost convention.

Probably the LIFO inventory method and accelerated deprecia-
tion have been adopted in some cases as partial recognition of the
effects of price levels on the income statement. A number of full-
adjustment systems have been proposed over the years. Accounting
Research Study No. 6—Reporting the Financial Effects of Price-Level
Accounting was issued just recently. I have not seen it, but I have
given enough thought to this question to know how extremely complex any adequate solution will be.

I have already referred to the form and substance situations that result from the failure of accounting to recognize values. I am quite aware that an attempt to replace cost with value would meet much opposition: I would oppose it myself, today. Nevertheless, the pressures for recognizing values are increasing and we are going to have to find some way to do it, at least in extreme cases.

In summary, as to the differences in accounting methods, practices, and procedures resulting from the absence or questionable validity of accounting principles, there is an urgent need to narrow these differences. There is a more urgent need, however, to establish the missing principles and to shore up those that appear to be shaky.

COMPARABILITY

I should now like to discuss the basic reason that uniformity is advocated; this is, uniformity will result in more meaningful comparisons between financial statements of different companies. This is not necessarily so. In fact, the reverse may be true.

Uniformity in depreciation, for example, can obscure the effect of differences in the patterns of use, replacement policies, and other circumstances. This may result in less, not more, comparability. To illustrate, assume a machine is expected to last from eight to twelve years, depending on usage. Uniformity might require the machine to be depreciated over ten years (mid-point of its life expectancy) on the straight-line method. If the machine cost $1,200, depreciation would be $120.

Suppose Company A planned heavier usage in its earlier life and replacement of the machine in eight years and provided $300 depreciation under the double-declining-balance method.

In contrast, suppose Company B planned steady usage over twelve years and provided $100 depreciation under the straight-line method.

Uniformity would provide an equal but non-comparable $120 in each case. On the other hand, while Company A’s $300 and Company B’s $100 would not be arrived at uniformly, they would be comparable. In this case, uniformity would result in less, not more, comparability.

We have uniformity today in accounting for advertising and maintenance expenses; they are almost always charged to expense
as they are incurred. This uniformity, however, does not result in comparability, except as a comparison of the amounts of expense each company incurred. The important things are the effectiveness of the advertising program and the adequacy of the maintenance program. The same point applies to accounting for research and development expenses on a charge-off basis. These important differences in conditions are arbitrarily put on a par by the uniform use of the charge-off method.

On a broader plane, accounting will fall short of producing comparable financial statements until it finds a means of making adjustments for changes in price levels and reflecting values in the statement of financial position. Furthermore, the ever present element of relative conservatism between managements, precludes complete comparability in many situations.

The fact of the matter is that it is, and likely always will be, beyond the capabilities of accounting to make financial statements of different companies completely comparable.

Where, you may well ask, does this leave the investor? It leaves him exactly where he is on many other issues when he is making investment decisions. He has to weigh many factors about any company under consideration: management, organizational structure, markets, products, future growth expectations, and so on. All of these factors have similarities and dissimilarities. It should not be surprising that the same is true of the financial statements.

I fully realize that, no matter what we do or say, investors and others will continue to compare financial information from different companies. Furthermore, I think the accounting profession has a responsibility to do what it can to minimize the chance that these comparisons will mislead someone.

Perhaps more important, we should emphasize to the public that significant differences may exist between the financial statements of different companies and that comparisons, particularly of single items—such as net income—from financial statements of different companies may be misleading although neither financial statement as a whole is misleading.

One of my biggest objections to the "uniformity" campaign is that investors will be misled into thinking that we are going to give them something we cannot possibly deliver.

Neither net income, nor net earnings per share, nor many other amounts in financial statements, are absolute—they never will be.
If they are in conformity with generally accepted accounting principles, they are within acceptable limits—limits that, unfortunately, neither we nor management can describe in dollars or percentages.

The investor and the public should be told this—let's not let them think we are trying to put something over on them or that we are better than we are.

SUMMARY AND CONCLUSIONS

Let me summarize. I have attempted to clarify the issue of uniformity in accounting by analyzing the existing differences to determine their nature and the reasons they have developed. I have discussed the effect of differences in circumstances, problems of form and substance, and the absence of a complete set of accounting principles. I have discussed uniformity as a means of achieving comparability between financial statements of different companies.

My conclusions are:

1. Substantial uniformity exists today; in some areas we need more of it and in other areas it is neither attainable nor desirable in our economy. In any event, uniformity should not be set up as our goal. Our real problem is to eliminate undesirable and unsound accounting results at whatever level they exist.

2. Differences in methods, practices, and procedures that result from differences in circumstances are necessary to fair presentation and no attempt should be made to eliminate them. However, we should attempt to confine their use to the appropriate circumstances, with reasonable—but not unlimited—leeway for relative conservatism.

3. Differences that result from problems of form and substance likely cannot be eliminated entirely. However, we need to achieve greater uniformity and comparability in these areas.

4. Differences that exist because of the absence of accounting principles should be narrowed as much as possible—but not arbitrarily. What is needed, of course, is the development of the underlying principles. We should not let a preoccupation with uniformity divert us from this important task.

The Director of Research of the AICPA is in the process of taking an inventory of generally accepted accounting principles and practices. From this inventory the existing differences can be listed and evaluated. Much progress can be made if we proceed in an orderly fashion without tearing the profession asunder and causing the public to lose confidence in us. If we ever do the latter, we shall cease to exist as a profession.