1970

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THE Accounting Principles Board
The leading authority on accounting principles for business is the Accounting Principles Board of the American Institute of Certified Public Accountants which issues official "Opinions" as guidelines for the business community and for the independent auditors of American corporations.

This booklet offers an insight into the Board's methods and objectives.
The thousands of industrial and commercial companies that make up the core of the American economy obtain a large part of their capital from investments by individuals and institutions, and from banks in the form of loans.

Because of this fact, confidence in the reliability of formal financial statements is a main pillar of our economic system. Without confidence, people would not, by the millions, put money in stocks and bonds, nor would banks so readily extend long-term credits.

A central factor in creating and maintaining confidence in corporate financial information is the accounting profession. Its contribution is twofold: it is the main source of financial reporting standards; and, as independent auditors, public accounting firms examine financial statements and express opinions as to whether they have been presented in accordance with acceptable accounting principles.

This has not always been so. In 1866 a request by the New York Stock Exchange for financial information from a railroad brought the reply that the company "makes no reports
and publishes no statements and has done nothing of the sort for the last five years."

By 1902 the United States Steel Corporation had published what may be considered the first "modern" annual report. As late as the 1930s, however, many reputable companies still omitted from their reports a good deal of important information—sales and cost of sales, for example.

Today, with few exceptions, corporate reports provide an abundance of reliable data. The improvement is the result of a combination of influences: efforts of the accounting profession, supported by the Securities and Exchange Commission and stock exchanges, and recognition by corporate managements that giving facts to the public serves their companies' interest.

A Landmark Document

During the Twenties, leaders of the accounting profession became concerned about some of the accounting practices companies were then using. The American Institute of Certified Public Accountants suggested to the New York Stock Exchange that the two organizations collaborate on establishing standards for financial reporting by the listed companies. Initially, the suggestion stirred little interest. But after the 1929 stock-market crash, attitudes changed, and discussions between the Institute and the Exchange led to correspondence that was pub-
lished in 1934 under the title "Audits of Corporate Accounts."

This proved to be a landmark document. It suggested broad principles of financial reporting—"accepted accounting principles"—and stressed the need for year-to-year consistency in the accounting practices of a company. From it emerged the first standard form of an auditor's report and an Exchange requirement that companies applying for listing have their financial statements independently audited.

During this period, as another reaction to the stock-market crash, Congress passed the first of the Federal laws for protection of the investing public. This, the Securities Act of 1933, set requirements governing the offering of new stock and bond issues.

The next year, the Securities Exchange Act of 1934 was adopted. This created the Securities and Exchange Commission as an independent agency of government to administer the Securities Acts, deal with stock-market trading, and oversee financial reporting by the listed companies.

One of the early actions of the SEC was to rule that companies under its jurisdiction be audited by independent public accountants. Although the early Acts empowered the SEC to prescribe accounting rules, the Commission made it known that it expected the accounting profession to assume the main part of this task. With few exceptions, SEC has followed that policy to this day.
Development of Accounting Principles

In 1938 the Institute formed a Committee on Accounting Procedure to “narrow the areas of difference in corporate reporting” by gradually eliminating less desirable practices. Over a period of 20 years, 51 Accounting Research Bulletins were issued, indicating preferred treatments of various items and transactions. Although these bulletins were advisory rather than binding, they became highly influential. They were supported by the SEC and the stock exchanges and were observed by the profession generally. (The SEC and the stock exchanges ordinarily will not accept a company’s financial statements if the auditor’s opinion contains an exception to the accounting principles used.)

Despite this progress, a feeling persisted, both within and without the profession, that there were still too many alternative accounting principles applicable in similar circumstances, yet regarded as “generally accepted.” When a company has a choice of accounting methods, it was argued, the management will naturally select those that present its performance in the most favorable light; since different companies may choose different methods, comparison of one company’s record with that of another becomes difficult.

It was also recognized that changed business conditions — new forms of financing, new tax laws, and the evolution of more complex corpo-
rate structures—outmoded some accounting principles and required the development of new ones at a pace faster than had been previously considered necessary.

The AICPA in 1959 therefore created a new body, the Accounting Principles Board, to succeed the Committee on Accounting Procedure and to carry on its work in a broader and more intensive way.

A few years later the Council, the Institute's governing body, adopted two important recommendations: (1) when a company audited by an Institute member uses an accounting method other than that recommended by the Board, the departure from the Board's position is to be disclosed in a footnote to the financial statement or in the auditor's report; and (2) variation in treatment of accounting items generally should be confined to those justified by substantial differences in factual circumstances. This second statement set a long-range goal for the APB.

APB Procedures

The Accounting Principles Board has 19 members, elected by the Institute's Council for three-year terms. At present, fifteen of the members are CPAs in public practice, two are financial executives from industry, and two are from the academic field.

Assisting the Board is a full-time administrative director with a staff of four and the
Board's Accounting Research Division with a staff of ten. The two groups include nine professional accountants.

Formulation of an Opinion usually involves the following steps:

- From a list of significant problems singled out by a planning subcommittee, the Board decides which projects should be undertaken in a given period.

- In many cases it authorizes a formal research study under the direction of the Accounting Research Division. The study is designed to cover: definition of the problem; theoretical considerations; practical considerations; and conclusions or recommendations. A project director is selected to supervise the research. He works with a Project Advisory Committee, appointed by the Director of Research with the approval of the APB chairman. The Project Advisory Committee ordinarily consists of several persons from industry, the universities, and practitioners who are particularly knowledgeable in the subject area. Periodic drafts are submitted to Project Advisory Committee members and frequently to other interested parties. When a study is completed to the satisfaction of all concerned, it is published and widely circulated.

- Besides publication in full, a summary of the study is published in The Journal of Ac-
countancy, thus giving it exposure to thousands of other people in the accounting profession, business, and finance. Comments are invited, and APB members give careful consideration to all responses.

* An APB subcommittee appointed by the chairman then reviews the study and recommends a course of action to the Board. (If the subject under consideration does not require a formal research project, the subcommittee undertakes whatever research is appropriate before submitting its recommendations to the full Board.)

* If the Board decides to issue an Opinion, the subcommittee prepares a first draft. It may contain:

  The reason for issuing the opinion.

  A brief description of the underlying research study and its findings.

  The recommended position proposed to the Board.

  The reasoning behind the position, which may include an explanation of why the subcommittee agrees or disagrees with certain parts of the research study.

* Each Board member reviews the draft, and his suggested revisions are considered by the full Board. Usually the subcommittee holds meetings with interested organiza-
tions representing industry and users of financial statements to discuss the basic points and to obtain informed views from them. Subsequent drafts are prepared until the Board reaches agreement that a draft is ready for "exposure."

The "exposure draft" of an Opinion is then mailed for comment to several thousand CPAs, business executives, security analysts, government officials, and others. It is also usually published in its entirety in The Journal of Accountancy.

After a reasonable time (generally not less than 60 days), reactions to the "exposure draft" are summarized and studied. Following discussion of still further changes that may have been proposed, a final draft is prepared for balloting by the Board. Each member assents, dissents, or assents with qualification. In the latter two cases, a statement of the member's position is included with the Opinion as finally published. A two-thirds majority approval is required for issuance of a formal Opinion.

The time from start of a research study to issuance of an Opinion may be several years. This painstaking process is followed in order to assure that all points of view have been considered and that an Opinion is broadly applicable, pragmatically feasible, and theoretically sound.
APB Opinions

Since its establishment in 1959, the Accounting Principles Board has issued (as of August, 1968) twelve Opinions:

1. New Depreciation Guidelines and Rules
2. Accounting for the "Investment Credit"
3. The Statement of Source and Application of Funds
4. (Amending No. 2) Accounting for the "Investment Credit"
5. Reporting of Leases in Financial Statements of Lessees
6. Status of Accounting Research Bulletins
7. Accounting for Leases in Financial Statements of Lessors
8. Accounting for the Cost of Pension Plans
9. Reporting the Results of Operations
10. Omnibus Opinion — 1966
11. Accounting for Income Taxes
12. Omnibus Opinion — 1967

Nearing completion are Opinions dealing with clarification of the "residual securities" concept, accounting for discount on convertible debt, and reporting changes in accounting methods.

In addition to the Opinions, ten studies by the Accounting Research Division have been published, from which some Opinions were derived and future Opinions may evolve: The Basic Postulates of Accounting, "Cash Flow"


Coping With Changing Conditions

Results of the work of the Accounting Principles Board are clearly visible in the increasing information now being provided in annual reports to millions of stockholders. Yet the work goes on, not only because there are still many important unresolved questions related to corporate financial reporting but because accounting principles are directed at moving targets that can shift with changing conditions: for example, the rise of so-called conglomerate companies, the marked increase in mergers, the proliferation of private pension plans.

Setting accounting principles is not a simple
task. To begin with, the subject matter is often complex.

Further, accounting principles are products of human intellect. They cannot, like the principles of physical science, be validated by reference to natural phenomena. There can always be honest difference about them, even among experts.

Each new APB Opinion causes changes in accounting procedures for some companies; the result may be reduction of their reported earnings, at least temporarily. Company managers naturally are not enthusiastic about this. The APB recognizes the responsibilities and prerogatives of management in presenting financial information on its business affairs. It realizes also that CPAs, to meet their own professional responsibilities, must have suitable standards to assure that the financial statements they audit are fairly presented.

The information produced by accounting is used by different groups for different purposes—credit grantors, investment advisors, stockholders, regulatory agencies, and by management. In performing its work, the Accounting Principles Board keeps all these diverse interests in mind. But its primary concern must be for the investing public and credit grantors.

By adopting this position in the development of accounting principles, the APB contributes to preservation of confidence in the free enterprise economy—and thus serves the long-term interest of business as well as the public.