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Albert A. Cardone

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Do the Principles for Financial Reporting Recognized by the American Council on Education Constitute Generally Accepted Accounting Principles for Nonprofit Organizations?

by ALBERT A. CARDONE
Principal, New York Office

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University Business Officers, New York — March 1969*

WHEN OUR MODERATOR invited me to speak today, he suggested that I address myself to problems of reporting what might arise as a result of the recommendations contained in the revised edition of College and University Business Administration (CUBA). The question that occurred to me immediately, probably because I am a practicing certified public accountant, was, Do the accounting principles recognized by the American Council on Education (Council) and contained in the revised edition of CUBA constitute generally accepted accounting principles?

This question is relevant to me professionally because it bears on the type of opinion I would express on financial statements that conform to or deviate from the recommended principles contained in the revised CUBA. The question should be relevant to you as college and university business officers because adherence to generally accepted accounting principles best achieves the objective of fair, consistent, and uniform reporting being demanded increasingly by governmental and private agencies, donors, creditors, and the general public.

I first approached this question by researching the applicable literature of the American Institute of Certified Public Accountants, seeking some reference therein to the earlier 1952 edition of CUBA or to the current one. My research, while not entirely fruitless, did little to resolve the question. The AICPA has neither endorsed nor disapproved the applicability of the principles contained in either edition of CUBA, and it has not issued a pronouncement of its own on college and university accounting principles. In fact, the AICPA's Accounting Principles Board has stated that its pronouncements have been directed primarily to business enterprises organized for profit.

Practitioners expressing opinions on financial statements on nonprofit organizations are guided by the statement of the American Institute's Committee on Auditing Procedure contained in Statement on Auditing Procedure No. 33 issued in 1963. With reference to nonprofit

organizations, this publication states that, *if the auditor believes that generally accepted accounting principles have been clearly defined* for the particular type of organization on which he is reporting, he may express his opinion as to the conformity of the financial statements either with generally accepted accounting principles or (less desirably) with accounting practices for nonprofit organizations in the particular field. Thus we see that the American Institute of CPAs clearly places upon the practitioner the responsibility for determining whether generally accepted accounting principles have been *clearly defined* for nonprofit organizations.

The only other applicable reference of note in the literature of the American Institute is contained in a publication entitled *Special Reports*, which was issued in 1960 by its technical services department. This publication suggests that the use of accounting procedures recommended by the American Council on Education, though differing in some respects from those generally followed by business enterprises organized for profit, should not be the cause for qualifying the auditor's opinion. For statements conforming substantially with the accounting principles recommended by the Council, it recommends that the auditor express an opinion saying such statements present fairly financial position and results of operations in conformity with generally accepted accounting principles or (alternatively, but less desirably) in conformity with accounting practices for nonprofit educational institutions.

DETERMINING WHETHER GAAP ARE CLEARLY DEFINED

Although the reference supports the position that the accounting procedures recommended by the Council constitute generally accepted accounting principles, *Special Reports* has to date been neither approved nor disapproved by the American Institute's Committee on Auditing Procedure. As a result, the practitioner, although he may obtain comfort in the above-mentioned endorsement of the American Council on Education, is not relieved of his burden of determining whether *generally accepted accounting principles have been clearly defined*.

Criteria for Deciding

At this point it became apparent to me that resolution of this question

would include, first, consideration of the criteria for determining when accounting principles are generally accepted, and second, subjection of the principles contained in the revised edition of CUBA to such criteria.

Although there have been conflicting views, for both profit and nonprofit organizations, concerning what accounting principles are generally accepted, there seems to be common agreement that a generally accepted accounting principle is one that has substantial authoritative support. The logic for selecting this criterion becomes apparent upon consideration of what it consists.

With regard to nonprofit organizations, substantial authoritative support would be sought by reference to practices commonly found in use, to the views of authors as expressed in textbooks and articles, and to the expressions of professional associations and societies whose objectives are the development of accounting principles consonant with the purposes of the institutions they represent.

The newness of the revised edition of CUBA prevents meaningful research to determine the extent of conformity with its provisions. In this respect, however, I am of the opinion that the revised edition should be viewed as generally an affirmation of the earlier edition; its revisions, although extensive, do not for the most part change the principles previously recognized. Rather, the revisions deal with additional disclosure requirements and alternative practices that may be used to observe the principles previously expressed.

The refinement of previously held positions, or the introduction of alternative accounting principles, is consistent with the manner in which generally accepted accounting principles evolve and does not invalidate their existence. Generally accepted accounting principles, unlike immutable laws of nature, are developed by man and should be viewed as rules for action designed to fulfill the needs of those who rely upon accounting. As a consequence, as those needs change, so do accounting principles.

COMPLIANCE WITH ACCOUNTING PRINCIPLES RECOMMENDED BY AMERICAN COUNCIL ON EDUCATION

The survey of college and university accounting practices conducted in 1964 by the National Association of College and University Business Officers indicates, in my opinion, a great deal of compliance with the

accounting principles contained in the 1952 edition of CUBA. Admittedly, in certain instances, responses to the survey indicated a variety of practices in certain areas. The term "generally," when used in the expression "generally accepted accounting principles," however, does not mean "relating to all in its class," but means, rather, "prevalent" or "widespread" use. It is for this reason that different practices in the treatment of apparently similar items may conform with the same basic principle.

An example of this anomaly in profit-oriented organizations would be depreciation. The principle is to allocate in a rational manner the cost of an asset over its useful life. The methods used to accomplish this include among others, straight-line, declining-balance, and the sum-of-the-years-digits.

An example for nonprofit organizations would be the different practices followed in observing the principle relating to replacement of existing educational plant facilities. An institution believing that its plant facilities can be replaced via philanthropy generally would not reflect in its statement of current revenue, expenditures, and transfers a provision for replacement of its plant facilities and would not set aside assets for the purpose.

Thus we see different practices in the observance of the same principle, with resulting different financial reporting effects. Admittedly, this impedes attainment of uniformity. I believe, however, that uniformity in financial reporting cannot, and should not, be attained in the absolute sense; there exist too many differences in management philosophies and accounting practices for absolute uniformity to be attained. I do believe, though, that the principal benefit of uniformity—*comparability*—may often be achieved if adequate disclosure is made. In that respect, my review of college and university financial statements indicated to me a need for improvement. Hopefully, compliance with many of the suggested reporting practices recommended by the revised edition of CUBA will go a long way toward attaining comparability in financial statements.

CONCLUSION

The foreword and preface of the revised edition of CUBA reveal that it comprehends the views of the National Association of College

and University Business Officers, consultants from the American Institute of Certified Public Accountants and the U. S. Office of Education, and individuals who by virtue of their position, experience, and published works should be considered authorities in this field. The synthesis of their views in the revised edition of CUBA has produced, in my opinion, as complete a statement of accounting principles for nonprofit educational organizations as currently exists. *I conclude therefore that the principles for financial reporting recognized by the American Council on Education do constitute generally accepted accounting principles for nonprofit educational institutions* for which there is substantial authoritative support.

I realize that the next probable question is, Would I, as a CPA, qualify my opinion when reporting upon financial statements that do not conform to the principles contained in the revised edition or CUBA? Although it is impossible to answer that question without considering all pertinent facts and circumstances, I should like to discuss briefly two factors relevant to its resolution.

The first is materiality. It must be remembered that the determination of whether generally accepted accounting principles have been adhered to requires judgment on the part of the practitioner. In the exercise of his judgment upon this question, reason dictates that materiality be considered. For example, it would be unreasonable to deny an institution an opinion that their financial statements are in accordance with generally accepted accounting principles because of minor deviations from strict adherence to the accrual basis of accounting when such deviations do not impair fair presentation of the financial statements.

Secondly, my conclusion that the principles recognized in the revised edition of CUBA constitute generally accepted accounting principles should not be interpreted as meaning that no other generally accepted accounting principles may exist or that future developments may not change or limit these principles. History of the evolution of generally accepted accounting principles refutes this; indeed, generally accepted accounting principles existed before being codified and set forth in a volume under the auspices of an authoritative body.

It should be remembered, however, that the burden of determining whether or not an accounting practice conforms with generally accepted accounting principles rests with the practitioner, who must subject it to the criterion of substantial authoritative support. If he concludes that a practice, differing materially from those recognized in the revised

edition of CUBA, does have substantial authoritative support, he would express an unqualified opinion on the financial statements. In the interest of comparability, however, I would suggest that, in such circumstance, full disclosure be made, either in the auditor's report or preferably in a note to the financial statements, describing the practice and its conformity with the principle concerned.

