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Accounting Research BULLETINS

October, 1948

No. 35



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Committee on Accounting Procedure,
American Institute of Accountants
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Presentation of Income and Earned Surplus

1. In Accounting Research Bulletins Nos. 28, 31, 32, and 33, two alternative methods of displaying items excluded from the determination of net income are indicated as being acceptable. Under the first of these methods, the excluded items are displayed in the surplus statement; under the second they are shown in the income statement after the amount designated as net income. Since the issuance of those bulletins, charges and credits displayed in accordance with the second method have been included in many income statements in a manner and with wording which has occasioned misconceptions as to whether the earnings for the period were the amounts captioned as net income or were the final and more prominent amounts shown on the income statements after the deduction or addition of such charges and credits.

2. The committee believes the possibility of misconception in this respect will be minimized by the adoption of the first method in all cases. Accordingly it recommends that the net income for the period be shown henceforth without deductions or additions of items which are properly excluded from the determination of net income. These items consist primarily of charges and credits with respect to (a) general purpose contingency reserves, discussed in Accounting Research Bulletin No. 28, (b) inventory reserves, discussed in Accounting Research Bulletin No. 31, (c) extraordinary items, which, if included, would impair the significance of net income, discussed in Accounting Research Bulletin No. 32, and (d) excessive costs of fixed assets and annual appropriations in contemplation of replacement of productive facilities at higher price levels, discussed in Accounting Research Bulletin No. 33.

3. The committee's recommendation is not intended to preclude or discourage the use of the combined statement of income and earned surplus recommended in Accounting Research Bulletin No. 8, provided the figure of net income is followed immediately by

the surplus balance at the beginning of the period; or is it intended to preclude the use of a separate statement showing the disposition of net income, if practicable. The committee is also of the opinion that deduction of the single item of dividends from net income on the income statement would not be subject to misconception.

The statement entitled "Presentation of Income and Earned Surplus" was adopted by the assenting votes of nineteen members of the committee, of whom four, Messrs. Duncombe, McDevitt, Stans, and Paton, assented with qualification. Two members, Messrs. Bell and Lindquist, dissented.

Messrs. Duncombe, McDevitt, and Stans assent to the bulletin but dissent from the requirement that charges and credits of the type referred to in clause (c) of paragraph 2 must appear only in the surplus account. They believe that charges and credits which would be excluded from the determination of net income under the criteria in Bulletin 32 should be permitted to appear ". . . at the bottom of the income statement immediately following the amount of net income . . . [including] them in the determination of the amount carried to surplus," in accordance with paragraph 12 of that bulletin. They also believe that the portions of this present bulletin which are inconsistent therewith should be changed accordingly. Mr. Paton assents to the Bulletin but does not agree with the implication that it is improper to charge depreciation to revenues on the basis of replacement cost, as found in the reference to Bulletin 33.

Mr. Bell dissents because he does not "believe that the developments of the last few months are sufficiently important to cause the committee to change its previously well-considered utterances on the subject." He states that, in assenting to Bulletin 32, he considered that the principal consideration was adequate disclosure, and objects to this bulletin because he believes it substitutes rigidity for reasonable flexibility.

Mr. Lindquist dissents from clauses (b), (c), and (d) of paragraph 2. He joins Messrs. Duncombe, McDevitt, and Stans in their objection to clause (c). He believes that permission to display on the income statement appropriations of earnings such as those contemplated in clauses (b) and (d) should not be denied since there is ample protection in adequate disclosure and proper captions.

NOTES

1. *Accounting Research Bulletins* represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached. (See Report of Committee on Accounting Procedure to Council, dated September 18, 1939.)

2. Recommendations of the committee are not intended to be retroactive, nor applicable to immaterial items. (See Bulletin No. 1, page 3.)

3. It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. (See Bulletin No. 1, page 3.)

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