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American Institute of Certified Public Accountants. Committee on Accounting Procedure

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Accounting Research BULLETINS

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No. 41

Presentation of Income and Earned Surplus (Supplement to Bulletin No. 35)

1. In part (c) of paragraph 2 of Accounting Research Bulletin No. 35, issued in October, 1948, the committee recommended that extraordinary items omitted from the determination of net income pursuant to Accounting Research Bulletin No. 32 should be displayed in the surplus statement* and not as deductions from or additions to the item of net income in the income statement. In its revised Regulation S-X issued in December, 1950, the Securities and Exchange Commission made provision in item 17 of Rule 5-03 for the addition to or deduction from net income or loss, at the bottom of the income statements filed with the Commission, of items of profit and loss given recognition in the accounts during the period and not included in the determination of net income or loss.

2. The committee's purpose in issuing Bulletin No. 35 was to prevent misconceptions as to whether the earnings for the period were the amounts designated as net income or were the final and often more prominent amounts shown on the income statements after the deduction or addition of items excluded from the determination of net income. The committee believes this purpose will best be served if reports to stockholders continue to display such items in accordance with the recommendation contained in Bulletin No. 35. The change in Rule 5-03, however, does not affect the determination of the amount to be reported as net income or earnings for the year and, in the committee's view, the additions or deductions at the foot of the income statement after determination of net income are equivalent to direct credits or charges to earned surplus.

* In Bulletin No. 39 the committee published as an approved objective a recommendation of the subcommittee on terminology that in balance-sheet presentation the use of the term "surplus" be discontinued. The committee believes that further experimentation with substitutes for the term is desirable in financial statements prepared for the general public. However, the committee plans to continue to use the term "surplus" in its bulletins as being a technical term that is well understood among accountants to whom the bulletins are directed.

The committee is, therefore, of the opinion that either the forms of presentation recommended in Bulletin No. 35 or the form required by Regulation S-X may be regarded as acceptable, and that it is permissible for a company to use one form in one statement and a different form in another like statement covering the same fiscal period.

3. Where, in harmony with the provisions of Regulation S-X, additions to or deductions from net income are displayed at the bottom of the income statement, care should be taken that the figure of net income is clearly and unequivocally designated so as not to be confused with the final figure in the income statement. The caption of the final figure should be descriptive of what it represents, such as "net income and special items," "net income and refund of 1945 excess profits taxes," "net loss and special items," or "profit on sale of subsidiary, less net loss." Any representation of earnings for the year or of earnings per share should be based upon the amount designated as net income.

4. Nothing herein should be interpreted as indicating any change in the committee's opinion that items mentioned in parts (a), (b), and (d) of paragraph 2 of Bulletin No. 35, consisting of charges and credits with respect to general purpose contingency reserves, inventory reserves, excessive costs of fixed assets, and annual appropriations in contemplation of replacement of productive facilities at higher price levels, should be displayed as charges or credits in the surplus statement and should not be shown in the income statement.

The statement entitled "Presentation of Income and Earned Surplus (Supplement to Bulletin No. 35)" was adopted by the assenting votes of the twenty-one members of the committee, of whom one, Mr. Wellington, assented with qualification.

Mr. Wellington approves the use of the form of statement provided in Rule 5-03 of Regulation S-X in financial statements filed with the Securities and Exchange Commission, but does not approve any departure in other financial statements from the recommendations in Bulletin No. 35.

Presentation of Income and Earned Surplus

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. *Opinions of the committee are not intended to be retroactive unless they contain a statement of such intention. They should not be considered applicable to the accounting for transactions arising prior to the publication of the opinions. However, the committee does not wish to discourage the revision of past accounts in an individual case if the accountant thinks it desirable in the circumstances. Opinions of the committee should be considered as applicable only to items which are material and significant in the relative circumstances.*

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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