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## To improve financial reporting

Robert M. Trueblood

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**TO IMPROVE  
FINANCIAL  
REPORTING**



Remarks by  
President  
Robert M. Trueblood  
to Council  
May 2, 1966

This statement by President Trueblood was presented to the spring meeting of the Institute Council at Boca Raton, Florida, on May 2, 1966.

Although it was delivered as an informal, off-the-record message, the members of Council, on motion of Past President Thomas D. Flynn, adopted a resolution providing for its distribution to the entire membership.

In offering his motion, Mr. Flynn described the remarks as "a splendid statement on our important and very difficult task of improving accounting principles." The Council expressed agreement by a unanimous vote.

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# TO IMPROVE FINANCIAL REPORTING

**Remarks by President Robert M. Trueblood  
to Council of the American Institute of  
Certified Public Accountants, May 2, 1966**

I'm using my "privilege of the floor" this morning in a quite special and somewhat unconventional way. I'm not presenting a "report"—of which you will hear many during the next three days. I'm not going to suggest any proposition which requires action by Council, *as an organized body*. Rather, I'm going to talk with you—as sincerely and simply as I can—quite personally—on a subject which I know all of us regard as extremely important.

For the past few years I've been concerned, as you have surely been, about the matter of *accounting principles*; about the questions and criticisms appearing in the press; about the doubts which such comments must arouse among people outside our profession; and about the possible divisive influences which could develop within the

profession over the philosophical issues which seem to be of concern.

There is no need to go over again what is familiar ground to all of us. Let me just recall to your minds—

. . . . . such a statement as that made by the *Wall Street Journal* in reporting the SEC action with respect to deferred taxes. I quote: “. . . the Accounting Institute found the issue too controversial and decided to defer action. Consequently, the SEC felt it necessary to issue its own statement.”

. . . . . or the speech by Mr. Laeri of the First National City Bank, in which he said: “. . . the accounting profession cannot say precisely—or perhaps even approximately—what ‘. . . generally accepted accounting principles’ are.”

Statements such as these understandably agitate CPAs. Our members tend to react either with general exhortation, or with specific proposals intended to remove the cause of the criticism.

On the exhortation side, I have received letters from members in all parts of the country deploring what they view as the slow pace of the Accounting Principles Board in issuing opinions. Wherever I speak, the main conversation piece during the cocktail hour is the “problem of principles.”

With respect to specific remedies, it was in the late 1930's that Adolf Berle, who is still an important spokesman on many economic issues, suggested that accounting principles be fashioned by a semijudicial procedure. Late last year, a monograph was issued by an accounting firm suggesting that perhaps

the profession should be giving consideration to the possibility of an Accounting Court which would have jurisdiction over all accounting regulations promulgated by the Federal agencies, including the SEC, in the event that the Accounting Principles Board cannot do the job well enough.

All these circumstances have led me to wonder about the causes—and the possible cures—of this mounting criticism—about whether APB could do the job which needs to be done within a reasonable time and, if so, what would constitute a proper rate of progress. I have pondered the concept of “comparability,” as it is used in reference to financial statements. I have reflected upon the definition of “uniformity,” as some of our critics use the word in speaking of accounting principles. And I’m aware that each of us, in speaking of these matters, tends to put emphasis on different points when discussing our overriding objective of improvements in financial reporting. I am aware that many of those who listen to us—investors, credit grantors, analysts, businessmen, financial writers—have little or no accounting background. And I suspect that many of them, not unnaturally, do not understand precisely what we CPAs intend to convey when we talk about accounting principles. But, most importantly, I have wondered how far apart some of us may really be with respect to the goal of improved financial reporting towards which we all strive.

I started with the premise that all of our number are reasonable men, devoted to the profession in a quite uncommon way. So, for my own information and better under-

standing, I undertook to discuss these many questions with a number of knowledgeable people, including practitioners, academicians, and users of financial statements. I have mulled over the substance of these many conversations at great length. And I want to expose to you this morning the conclusions that I have derived from this effort.

**First, why so much comment and criticism in the press about accounting principles?** One obvious cause is the often-mentioned growth in the investment market and in the numbers of shareowners. This fact, in itself, has increased the interest of both security analysts and the business press.

Another cause is a pair of *misconceptions* which we accountants may have aided and abetted ourselves. The first misconception is the idea that financial statements are simply an enlarged version of a man's counting up the small change in his pants pocket. The second misconception is that an auditor's opinion is somehow regarded as an absolute guarantee of financial health and managerial wisdom.

In my view, it is clearly necessary to explain, in ways in which the average newspaper reporter and reader will grasp, what the real meaning of financial statements is. While financial statements are indispensable to our society, such statements are in fact compressed quantifications, in terms of money, of properties and relationships that are not always readily quantifiable. The financial statements usually appearing in annual reports are all-purpose, *summary* statements. Some users, such as analysts and

lenders, must come to recognize that all the data they wish cannot be found in a single set of summary statements—and that they must go elsewhere for at least some of the information they require. Further, on this same point, is the fact that we accountants have not made it clear that many estimates and judgments are involved in the preparation of financial statements, no matter what accounting principles are used or employed. Few non-accountants understand, I fear, that precision in an income statement for a single year is unattainable. The truth is that financial statements are probabilistic in nature—not deterministic. And I'm afraid that we ourselves at times have contributed to the lack of understanding on these points.

As for the auditor's opinion—and the public misunderstanding of its significance—it seems to me we had best start explaining loudly and strongly that our opinion is nothing more or less than an *opinion*. What's more, it's an opinion which of itself involves many judgments. It can be argued that the words in our standard opinion should be changed or rearranged—a subject recently under consideration by the Auditing Procedure Committee. After all, we've used essentially the same language for 30-odd years and any simplification or clarification of that language which would be helpful, would of course be desirable.

But, to my mind, the main thrust of our problem is that we are going to have trouble of one kind or another so long as users of financial statements do not understand the intended meaning *and the limitations* of the statements themselves and the meaning of a professional auditor's opinion—even if

overnight we eliminated every available alternative accounting principle or procedure on the books.

**Still a further cause of criticism is a subtle, underlying doubt of the CPA's independence.** Last month I asked half-a-dozen financial editors in New York to dinner, in an effort to find out what might be on their minds of concern to us. And many of their questions revealed—politely, it's true—some notion that when a company wants “to dress up its profits,” the auditors either help by finding a convenient accounting method among many alternatives, or that the auditors indulgently go along with a method which the management might choose in order to best serve its own purposes.

Here again, progress on principles is not going to help us if *confidence in our independence* is lacking.

And I think I must warn you that the question of independence is being raised not only in the press. You will hear something later in this meeting about questions as to the relation of management services to audit independence. And we cannot brush these queries away. Our rules of independence—no matter how meticulously worked out by our committees—will be acceptable to the public, only if the public understands our position and believes in our integrity. In the final analysis, our rules and attitudes about independence must satisfy society, rather than only ourselves.

The last cause of public criticism I will mention is the fact that, once started, carping tends to be self-generating. By this I mean that when a reporter reads a story by one

of his competitors along the lines of those I quoted a few minutes ago, the reporter feels an impulse to get on the band-wagon. One critical commentary breeds another. For instance, writers for two important newspapers who recently interviewed some of our members gave the impression that they were already convinced there was something wrong with accounting, and that their mission in the public interest was to ferret out the hidden truth.

I think you may reasonably expect some more rather unfavorable stories in the financial press. We know of at least two presently in the making. They may come out all right. They may be bad. But I should remind you that anything we do or say after a story has hit the street is defensive, and therefore has a negative tone. And a defensive response inevitably tends to perpetuate the original criticism.

What we really need is a series of constructive, positive accomplishments that we can take to the press with pride. Given a series of such accomplishments, I predict that our press will become much better—very quickly. For those of you who know merchandising—and however you may feel about APB Opinion No. 5 and ASR No. 102—I am certain that changes in reporting in that industry for the year 1965 will have a strong and good influence.

**Let us move now to the question of APB effectiveness.** About a year ago the APB took a fresh look at itself and, as a result, instituted several changes in organization and procedure. A planning committee was formed to set up a program with priorities

and target dates. An administrative director was named and provided with assistance. Subcommittees were created to expedite work on projects, and several firms are contributing significant amounts of volunteer manpower—over and beyond the heavy demands of Board membership itself.

Closer relations have been established with the Financial Executives Institute, the American Accounting Association, the Federation of Financial Analysts, and many other industry and user groups.

Cliff Heimbucher, as Chairman of the APB, is largely responsible for these improvements. He will report to you later in this meeting on the status of current APB projects—but he has already told me that the APB's meetings here in Boca Raton last week were perhaps the most encouraging and the most productive in the Board's history.

No one can deny that standards of financial accounting are essential in our society. It is not only logical but, in my estimation, imperative that these standards be set by the Institute—and that means by the APB.

This is so, I believe, because there is no other non-governmental agency that can do the job. And certainly no thoughtful person, familiar with the problems, would be happy to have government undertake the job. Accountants would not be pleased with such a solution. Business certainly would not be. And, according to statements of its spokesmen over the years, the SEC would not desire to have the assignment thrust upon it. Industry itself is not organized to assume the task of defining accounting principles and procedures. Although individual corporate managements may sometimes object to

specific conclusions of the APB, I firmly believe, in the long run, that management as a group will be glad to have the accounting profession shoulder the primary responsibility in this matter.

Thus the role of the Institute, through its Accounting Principles Board, becomes one of leadership. This does not mean that we must try to obtain a complete consensus on every accounting question. The interests of users involved in the solution of any particular problem often differ (and usually represent various levels of sophistication), so it is unlikely that a complete consensus can ever be developed on any technical question. At the same time, leadership does not mean making decisions in an ivory tower, without respecting the views of interested groups. What leadership in the establishment of principles does mean is this: identifying and exposing problems; researching them; suggesting solutions; giving everyone a fair hearing; weighing all views involved; and publishing clear-cut, well-reasoned, and well-documented decisions.

It is my conviction that the APB can do this job, with the support of the SEC. The support of the New York Stock Exchange would be additionally helpful. Indeed, support of all parties at interest is almost certain to be forthcoming if the Board shows resolution, and is able to make reasonable progress.

**Our overall objective, clearly articulated in the Seidman report, is to reduce the number of alternative practices not justified by actual differences in circumstances. But while this objective is being pursued, prog-**

ress can also be made through disclosure requirements, recognizing not only that disclosure can be of itself a contribution to improved financial reporting, but also remembering that disclosure is not a substitute for accepted practice when authoritative criteria do exist.

In the light of all the conditions I have described, the APB has decided to focus on a few important problems rather than to try to deal simultaneously with all the problems that need attention. I feel strongly that the solution of several complex problems will demonstrate the ability of the Board to grapple successfully with difficult subjects.

But this alone is not enough. If the establishment of standards is to remain in the hands of the profession, observance of the standards *in practice* is crucial. Fortunately, there is every reason to believe that if the Accounting Principles Board produces clear-cut and well-reasoned opinions, they *will* be supported in practice by the entire membership. I need not remind you that observance is in your hands—as individuals, as representatives of the firms in which you are partners, and as representatives of your constituents across the land. Recognition of the authority of APB opinions by each of you, as elected representatives of the Institute, will be the strongest possible influence towards recognition of the authority of APB opinions throughout our profession.

I personally think that a minimum definition of reasonable progress by APB might be to solve, say, three problems of importance within the next year and a half. Within three years the APB should have produced some acceptable statement of basic concepts, the

nature and purpose of the statements on which we express our opinions, and the assumptions on which we decide whether the various items are fairly presented.

I am persuaded that the Board has the will and the means to do all of this—and I earnestly suggest that unless and until the opposite is proved true, there be a moratorium on internal criticism. I suggest that the Board be allowed—at least for a time—to pursue its work unhampered by a need to defend itself among its own colleagues. Self-criticism is good to a point. But at some point it is better to save our energy, in order to get on with the job.

**My final remarks deal with the question of how much actual difference exists within the profession on the matter of generally accepted principles and procedures.**

Maybe not all of you will concur, but I am bound to say that after reasonably extensive consideration, I am of the opinion that disagreement is not nearly so wide as persons outside the profession have inferred—and continue to write about.

There is among the membership, for example, what I believe to be a unanimous view that a specified and detailed listing of accounts with mechanistic requirements for presentation—either for industry as a whole, or for specific industry groups—would not be possible, or practical, or desirable.

There is agreement, I believe, that the objective of the APB should *not* be to get out a series of “rule books”—covering every kind of transaction in all kinds of circumstances, and prescribing the accounting for

each. Rather, I think there is a general view that the APB should recommend accounting practices which will make *like* things look *alike*, and *unlike* things look *different*. No one denies that mechanically uniform application of principles could actually work against the accurate description of business events.

Without any exception that I am aware of, the members recognize that there are marked limitations to comparability as between different companies. At the same time, they all recognize that *unnecessary* obstacles to comparability can be reduced by gradually restricting the use of alternative accounting practices to those warranted by differing circumstances, as defined by explicit criteria.

It is also recognized that there are some alternative practices which are so deeply embedded in corporate experience that restricting selection to actually differing circumstances might be more disruptive than helpful. Lifo has been used since the late 30's without regard to the nature of inventories. Tax considerations overwhelmed accounting theory in this case. In depreciation accounting, the use of a variety of depreciation methods is presently a matter of judgment and choice. I think these kinds of things cannot be changed quickly—if indeed it were really important to do so, in the public interest.

I think that it is generally accepted that even when the only alternatives used are those warranted by differences in circumstances, there will still be assumptions and judgmental decisions with respect to the circumstances in specific applications.

There is agreement that progress demands not only the selection of the best principles and practices from among existing possibilities, but also that there must be a constant effort by APB to develop new and better principles and procedures. This means in fact that the introduction of a superior principle or practice could actually *increase* the number of permissible alternatives, at least for a time.

**In beginning these informal remarks, I said that I had for some years felt concern over the many questions involved in our concepts of accounting principles.**

In concluding, I can say that after probing into these questions, I am of good cheer. I think that the criticism our profession has undergone has not been without its blessings. For one thing, the criticism, of itself, has attested to the importance of our profession. All this attention would never have been paid us if CPAs were still thought to be just a lot of little fellows, useful perhaps, but mostly puttering around on the periphery of what is really significant in life. And this criticism has moved us to exercises of introspection and self-examination which we might not otherwise have undertaken. We have made substantial progress in improving the tools we use in serving society. And, I am convinced, we are on the threshold of still greater accomplishments.

While we advance toward these accomplishments, we certainly should not wring our hands in public because we have not attained perfection already. Neither has anyone else. But neither should we encourage people to believe that there will be a

sweeping reduction of alternative accounting practices in the immediate future. This is simply not so. This will take time. Even when reductions are attained to the extent that is possible and desirable, it will still be necessary for non-accountants to understand better the values and limitations of financial statements, and the meaning of auditors' opinions.

Especially I urge that we do not repeat over and over that if the profession doesn't do something about generally accepted principles, the government will. I say this not by way of arguing the validity or the invalidity of that proposition, but I say it because that sort of attitude is simply not constructive. You know, for example, that if enough people begin saying that a certain bank is about to fail, they may bring about a run on the bank that will put it in trouble even though it was entirely sound before the rumors got started. This is what the social psychologists call a "self-fulfilling prophecy."

There *have* been disagreements within the profession about the most appropriate means for making progress on principles. There will *always* be differences of viewpoint among us. That is healthy and that is good. But there is no disagreement as to the end we seek, which is the continued improvement of financial reporting and of our ability to serve society. I submit that when reasonable men hold a common objective, share membership in the same organizations, and keep channels of communication open between themselves—these reasonable men can reach agreement on the path to be followed and the decisions to be made.