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Accounting Principles Board

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THE ACCOUNTING PRINCIPLES BOARD

Accounting principles both guide accounting practice and are derived from it. This apparent circularity points up both the utilitarian aspect of accounting and its orderliness.

The development of accounting principles involves a quest, and an act of creation: it includes a search for the guides or standards that have been useful in portraying the financial position and operations of a business. It also includes creation of a theoretical framework which correlates the guides, making them adaptable to many types of businesses and providing the orderliness that is necessary for comparability.

Comparability of financial statements has always been an important goal of accounting. The need for such comparability, as between both businesses and individual years, has grown with the development of a complex capital market in which investors make choices on the basis of knowledge obtained from financial statements.

Comparability requires differences as well as similarities to be highlighted. One such difference (or similarity) concerns management expectations. The financial picture of a business, showing where it has been and where it is, reflects management attitudes to the extent that they have affected operating decisions. Companies' financial statements are not comparable, no matter how uniform they may appear to be, unless they reflect such management expectations, which create the varying economic personalities of businesses. For example, one management will replace assets in response to certain economic stimuli, while another will repair its old equipment because it views other factors as more important. Some executives will extend research when business is not good; others will curtail it. Some will diversify operations in the identical circumstances in which others will contract or simplify them. Thus deferrals and accruals appropriately reflect man-



Weldon Powell

agement expectations. These and other complexities affecting comparability make it difficult to articulate comprehensive accounting principles.

The Accounting Principles Board, now four years old, is the group designated by the American Institute of Certified Public Accountants to supervise the basic research necessary to identify and derive accounting principles, to consider the practical application of such research, and to recommend the extent of their acceptability to the profession. The predecessor group, the Committee on Accounting Procedure, dealt with comparability in selected special circumstances. At various times in its life of just over 21 years, the Committee on Accounting Procedure considered the need for a comprehensive statement of accounting principles, but did not formulate one. Nonetheless, the Committee's pronouncements form a reasonably complete structure of accounting principles.

On its establishment in 1959, the Accounting Principles Board set out to

identify the postulates of accounting and the associated broad accounting principles. It was recognized that extensive research would be required for this task. The first four years of the Board, when its chairman was Weldon Powell of our Firm, were given over largely to the formation of a research group, to clarification of purposes and methods of operation, and to consideration of several initial studies developed by the newly formed research arm. The early studies dealt with some important matters, including basic postulates and principles, pursued largely through deductive research.

A number of the studies' conclusions have not been tested fully in practice or comprehensively appraised in relation to usefulness. Recognizing such appraisal of these concepts as basic to their general acceptance, the Board in a formal statement said that some exposure and testing of the conclusions of the study on broad principles would be necessary to evaluate their practicability. The laboratory for such testing is,



Maurice Moonitz

of course, in business itself. An important aspect of the Board's work is to evaluate the testing of accounting theories in actual business situations.

Thus the Board is faced with the challenge of finding the proper relationship between deductive reasoning, which gives order and consistency to the structure of accounting theories, and the testing of theories for their practicability, which makes them useful. Definition of comparability and of the right amount of uniformity in financial statements to achieve it is a central consideration of the profession and the Board. Too much uniformity may obscure significant differences, and too little may lead to alternative practices where the circumstances are alike. The distinction between accounting princi-

ples and their application must remain clear and sharp. Uniformity of principles is a desired end. Uniformity of application may destroy comparability by obscuring differences in unlike circumstances. There is no room for quirk or whim in establishing principles, but manifestly in applying them there must be room for recognition of variations in underlying conditions.

The best of the profession's capabilities are required to achieve these ends. The Institute and the profession have recognized this need by selecting outstanding men to serve on the 21-man Board and on the project advisory committees and staff that develop the research studies under the Board's direction.

It augurs well for the profession that substantial investment is being made in the Institute's comprehensive research effort, and that its leaders are willing to contribute their time and thought unstintingly. The present annual budget of the Director of Accounting Research and his staff is in the neighborhood of \$180,000. The post of Director has been held since 1960 by Dr. Maurice Moonitz. He returned at the end of July to his accounting professorship at the University of California, but has been elected a member of the Board for a three-year term that started in September. Mr. Paul Grady, a retired partner of Price Waterhouse & Co., has replaced Dr. Moonitz as Director of Accounting Research.

The Board, of which Alvin R. Jennings of Lybrand, Ross Bros. & Montgomery now is chairman and John W. Queenan a member, is entering a second phase of its activities. It is taking stock of the accounting principles that can be regarded as generally accepted today. This inventorying should point to aspects of accounting requiring attention if differences in accounting practices are to be narrowed to reflect variations in underlying conditions. Re-

search into special problems also continues; studies of accounting for pension costs, for non-profit institutions, for intercorporate transactions, for matters peculiar to international operations, and for price-level adjustments are among these.

Each study is set up as a separate project, with a director and necessary staff aided by a temporary project advisory committee composed of five or six people. While all members of each advisory committee need not be members of the Institute, the chairman must be a member of the Board. The Director of Accounting Research may publish each study as he sees fit, provided he has approval of the majority of the related project advisory committee; approval of the Accounting Principles Board is not required. Thus the published studies have only the influence merited by the standing of their authors and the cogency of their arguments.

The published studies are distributed widely. This stimulates discussion in professional, academic, and business circles and helps the Board decide what action it should take. If the positions taken in a study are acceptable to the Board, a supporting opinion usually is issued to AICPA members. If the Board disagrees with a study, it must make its position known publicly. It may also postpone action until the subject has been studied further and exposed to additional testing and public reaction.

By thus seeking the reactions of others interested in and affected by what accountants think and do, the profession induces the development of accounting thought by persuasion, a procedure it has learned over the years to be sound in winning acceptance of concepts and standards. Patient and reasoned thought has been reaffirmed as the only really effective approach to gaining acceptance by business of meaningful modes of presenting financial information.