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The APB: A Member's View

An Interview with Donald J. Bevis

When the stock market crashed in 1929, it dragged down with it the haphazard—and often non-existent—methods of financial reporting that had been in use.

Although the old methods died slowly, the crash was the shock that began the dialogue which resulted 30 years later in formation of the Accounting Principles Board. The 18-member Board now sets the standards for financial reporting in the United States.

The APB of today evolved through two other bodies that began to establish uniform standards for the accounting profession.

The first effort resulted in "Audits of Corporate Accounts," which appeared in 1934. This publication consisted of the correspondence between the American Institute of Certified Public Accountants and the New York Stock Exchange, that began shortly after the crash, regarding the need for standards for financial reporting by listed companies.

Audits of Corporate Accounts suggested "accepted accounting principles" and stressed the need for consistency in the application of accounting practices. From the document emerged the first standard form of an auditor's report and an Exchange requirement that companies applying for listing have their financial statements independently audited.

Also in 1934 the Securities and Exchange Commission was created with duties that included overseeing financial reporting by listed companies. However, the SEC made it known that it expected the accounting profession to assume the task of prescribing accounting rules.

In 1938 the AICPA established a Committee on Accounting Procedure and charged it with "narrow(ing)

the areas of difference in corporate reporting." Although the Committee offered considerable help, issuing 51 Bulletins over a period of 20 years, the profession was still unhappy with what it considered too many alternative accounting principles applicable in similar circumstances yet regarded as "generally accepted."

To correct this, the AICPA created in 1959 the Accounting Principles Board to take over the work of the committee with a stronger hand.

The APB is made up of 14 CPAs in public practice, two financial executives and two academicians, all of whom are elected for three-year terms by the Institute's Council. The Board is assisted by a full-time administrative director and the Accounting Research Division. These two groups include ten professional accountants.

The members of the APB accomplish their work primarily through Opinions, issued generally after several years' consideration and always with the approval of two-thirds of the Board, and Accounting Research Studies, which often are the spadework of the Opinions. Fourteen Opinions and ten Studies have been issued.

Opinions of the APB are the recommended procedures for accounting matters. All accountants are obliged to follow the pronouncements or to report the departure and its effect. If an accountant does not report a departure, he is considered to be using sub-standard reporting.

Although there is nothing in law, it is almost universal in practice for the SEC and the stock exchanges to refuse any financial statement that includes a departure from an APB Opinion. These sanctions result in almost complete adherence to the APB pronouncements, even though the Institute has no enforcement machinery.

The interview that follows is with Touche Ross' member of the APB. Donald Bevis is now serving his fourth year on the Board.

1. The Accounting Principles Board has been criticized for not reaching clear-cut Opinions—and for taking too long to do even that. Do you find these valid criticisms?

In my opinion, the Board does reach clear-cut Opinions; however, many of the issues that are involved are so complex and controversial that it is necessary to make certain compromises in order to arrive at a conclusion that would be generally satisfactory. To me, this is a healthy state of affairs because it does give recognition to different points of view and to different problems in industry. Many of the reasons for stating that Board Opinions are not clear-cut come from the refusal of some people to recognize that there are differences in business and in appropriate accounting practices and that you cannot achieve rigid uniformity or absolute comparability in all areas because companies by themselves are not similar in their characteristics.

Part of your question involves the amount of time it has taken the Board to reach some of its Opinions. We must realize that the charter of the Board properly provides for extensive research to be done and for that research to be made available—not alone to the Board but to outsiders for review and comment. Upon analysis of the comments and discussions with other interested parties, the Board then proceeds to make a determination of what in its opinion is the proper accounting. Because of the requirements it usually takes the Board from a year to two years to arrive at a decision on any complex subject that would be worthwhile under the circumstances. To arrive at a decision at any earlier period of time could result in ill-considered points of view with their obvious poor impact on users of financial statements.

2. Would a change in the composition of the APB make the Board's work more successful?

I feel that any change in the Board's composition could have a damaging effect. As a practical matter, much of the research that is being done by the larger accounting firms is of direct benefit to the APB and the profession. The elimination of their representatives from the Board could in many ways deprive the other Board members of the benefit of their extensive experience and research.

The suggestion has also been advanced that the

Board's composition should include a greater number of industry representatives. Here I would take disagreement because I believe that the Board can obtain knowledge of the points of view of industry through meetings with its official associations and other means of contact. Meetings with these associations generally can and do give the Board the required amount of information and background that is necessary to have an adequate understanding of the problem. Furthermore, to increase the number of industry representatives on the Board could, in my opinion, lead to the conclusion that the Board lacked objectivity and was not an independent body designed to follow through with its quasi-legislative responsibilities.

3. Do you believe the Board has been too quick to bow to pressures against its pronouncements?

I recognize this accusation has been made but I don't agree with it. The effectivity of the Board can be no greater than the acceptance of its proposed Opinions—by the profession, by the SEC, by users of financial statements. I am not talking about a popularity contest. If in the minds of knowledgeable people a proposed Opinion is incorrect or incapable of being properly applied, then the Board must take into consideration these differing positions.

4. How strong is the influence of the Securities and Exchange Commission on the APB? Do you agree with the manner in which the two work together?

There has been an unwritten agreement between the SEC and the APB that they will discuss in advance any material accounting issues. Unfortunately in a few instances the SEC has taken the initiative and set forth its own rules without determining the point of view of the AICPA. Their argument, presumably, also has been that the Institute was moving too slowly, and that the SEC, in the interest of protecting the investor, needed to take more positive action on a more timely basis. I do not believe that the SEC should decide what are the proper accounting principles or practices. They should be the policing authority, which is in a position to make certain that pronouncements of the profession are being followed. If any additional enforcement machinery is necessary, it should be effected through the application of the AICPA Code of Professional Ethics.

It is quite true that the SEC has attempted to influence the Board in its scheduling of important issues. I think this is desirable because the SEC, through the very large number of financial statements filed with it, probably is in the best position to know what are the most contro-

versial areas. Their suggestions to the Board as to what should be dealt with first do not indicate to me that the SEC is attempting to take over the establishment of accounting principles. All they are trying to do is to see that the critical issues are resolved on a more timely basis.

5. *There was more-than-usual discussion and criticism of APB Opinion No. 11. How has it been received in practice? And, if it has not been well received, is there a possibility it will be withdrawn?*

As to APB Opinion No. 11 dealing with Accounting for Income Taxes, I believe that it has received general acceptance in professional practice. Some industry groups still object to it. It is interesting to note that those on the Board who dissented to the Opinion have publicly stated that they intend to enforce it. However, this does not mean the Opinion may not be changed in the future if a substantial body of reason is developed that would suggest to the Board that its conclusions in the Opinion were wrong or should be modified. But until such authority is developed, I can see no reason why the Board would withdraw it.

6. *Two of the most controversial topics now before the Board are reporting by conglomerates and accounting for business combinations and goodwill. What is the status of each now and what does the future hold for resolution of the questions?*

I believe that the former (reporting by conglomerates) will be easier to resolve than the latter. To me it is quite apparent that some additional reporting should be required of conglomerates. First, however, we must define a line of business. The extent of the reporting, however, should depend on the results of the current voluntary experimentation that is going on and a practical solution to the problem of allocation of common costs and expenses among different lines of industry.

With respect to business combinations and goodwill, I think there will be a period of considerable disagreement before any compromise point of view will be reached. I think it is too early at this time to tell as to how that matter will be resolved. One of the basic issues to be resolved is under what circumstances, if any, is "pooling" accounting appropriate. It is my personal opinion that purchased goodwill should be accounted for just as any other acquired asset is accounted for, and that the cost of this goodwill should be related to future revenues or future time periods. In determining the amount to be assigned to purchased goodwill, I believe too much attention has been focused on what

might be called superficial market values and that the real values have been ignored. I recognize, however, that the determination of real values may be completely subjective and would be difficult to determine. Nevertheless there are many other areas of accounting where subjective evaluations have to be made, and I believe that the profession should be able to resolve this issue.

7. *Does the profession, in your opinion, need an APB Opinion on price-level accounting? Will such an Opinion solve the problems of accounting for the dollar in periods of inflation?*

I believe a pronouncement on price-level accounting should be issued. There have been many statements on the part of the profession in the past that price-level accounting is appropriate in many situations; however, at no time were adequate or suitable guidelines laid down as to how price level accounting should be reflected or used. The proposed pronouncement of the Board does lay down these guidelines, and, presumably, if anybody is to adopt price level accounting, he would follow these guidelines.

Of course, we all realize that one of the arguments against price-level accounting in the United States has been that inflation has not had a serious impact on our economy. However, I believe this has been disproved in recent years because the rate of inflation has been growing. Even if a statement on price-level accounting is issued by the Board, I doubt very much that it will receive wide acceptance in the U. S. There will be a natural lethargy to changing the form of corporate reporting. Many people in industry will consider it a nuisance rather than a desirable goal for the benefit of the public investor. There are, however, some industries where the impact has been greater. Here I believe corporations will be prepared to show what effect inflation has had on their financial statements over a period of time. We all know that inflation has run rampant in many other countries and any pronouncement should assist in resolving the practices that should be followed in those countries.

I firmly believe that "value" accounting should be the long-range goal of people interested in good corporate reporting. At the present, however, neither the profession nor the users of financial statements are prepared to develop the appropriate procedures for evaluating subjective information. Until these procedures are developed, it would be improper to try to apply value accounting. As I see it, price-level accounting is only an intermediary step.

8. *Is an opinion on materiality in sight?*

The problem of materiality has been facing the profession and others interested in financial reporting for a good many years. Obviously it would be desirable to establish workable concepts that can be followed in determining what is or what is not material. However, here you have to face up to the different points of view of the people responsible for preparing and those using financial information. What may be material to one person is not necessarily material to the other. And until we can obtain a reconciliation of these points of view, I believe it's going to be exceedingly difficult to lay down rules that must be followed in dealing with the question of materiality.

9. Has the recent flurry of litigation against CPAs had any effect on the work of the APB?

The impact of litigation on the accounting profession—and more particularly on individual accounting firms—has had its influence in Board activities. The Board is attempting and will continue to attempt to resolve differences in reporting practices, particularly where they may result in controversial issues. While the Board is not specifically interested in any particular legal case, they are interested in the interpretations that people make when they are dealing with matters that are subject to litigation as well as matters that are involved in every-day reporting. It would be outside the scope or province of the Board to deal specifically with any par-

ticular issue involved in any legal case. The Board is charged with defining principles and is not responsible for attempting to deal with isolated situations or isolated reporting practices. If the Board were to deal with these matters, then practically their entire time would be taken up in the interpretation of the application of accounting principles and practices.

10. After serving four years on the APB, how do you view the experience?

The work on the Board is indeed very time consuming; however, it is most interesting. Often I observe how members of the Board change their initial points of view after a matter has been thoroughly discussed either within a sub-committee or among all Board members. This, to me, is good because it does bring out that there are different points of view on any particular issue; and that if these issues are to be resolved, it is necessary to have a complete interchange of ideas and points of view. The Board has been criticized by some for taking rather hasty actions on certain of these issues. Nevertheless, I do not believe that this is all bad because we are dealing with a rapidly changing business environment. Business practices are subject to constant change; and if the Board is to discharge its responsibility, it should be prepared to deal with these new issues as they arise. This will result in changing points of view among Board members and amendments of previously issued Opinions.