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APB in a Time of Change: Report to Council of the AICPA

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THE APB IN A TIME OF CHANGE
REPORT TO COUNCIL OF THE A. I. C. P. A.
BY LEROY LAYTON, CHAIRMAN OF APB

INTRODUCTION

It is my privilege today to help you examine the APB in a time of change. This will be my last Spring council meeting as an APB member; at the end of 1970, I will have served the limit permitted under the Board's charter.

THE APB AND YOU

Each of you, and those you represent, have a very real stake in the Board's success. The Board's effectiveness in improving financial reporting and the underlying accounting principles, is of far greater importance to you than the difficulties we may seem to be causing you.

Difficulties in:

1. Dealing with some unhappy clients who do not like what we are doing.
2. Reading and applying rather complicated opinions.

Your real concern, of course, should be whether or not the Board is moving fast enough and conclusively enough in fulfilling its charge in a complicated environment of change.

THE BOARD'S CHARGE

The Board is one very important phase, but only one phase, of our profession's determined effort to assume public responsibility and

leadership in setting standards for improved financial reporting. To do this, the Board has been charged with both:

1. Giving attention to the broad fundamentals of financial accounting, and
2. Handling specific accounting problems, generally in the area of alternatives.

The Board's efforts to meet its first charge are not nearly so visible as are those expended on its second. We have been accused of spending all of our time on "putting out fires" and ignoring the basics. This is not so! In spite of the roaring fires, we have spent considerable time on fundamentals.

The first research study produced under the Board's program covered basic postulates, the third was on broad principles and the seventh was an inventory of existing principles.

A very able committee of the Board, supported by the AICPA Research Division, using these studies and comment engendered by their exposure, has spent five years preparing a very lengthy draft of a Statement entitled Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises. This has been reviewed by the full Board and has been studied by a special committee of the American Accounting Association (AAA). Comments received from the AAA were studied by our committee and a second draft has been finished. The full Board completed its review and discussion of the second draft last Saturday. Other organizations,

who cooperate with the Board, have been given copies of the second draft for their study and comment.

Issuance of this Statement is expected before the end of this year. This will be only the first step towards a sounder conceptual foundation for accounting principles. Hopefully, it will lay the groundwork for moving into more controversial areas.

THE BOARD'S RECORD OF CHANGE

In appraising the APB's ability to cope with future changing conditions, a look at the past is in order. The Board has made far more changes in its organization and procedures than most may realize. In its 10-1/2 year history the following have happened:

1. Authority

This Council, 5-1/2 years ago, increased the authority and stature of the Board by requiring disclosure of departures from Opinions.

2. Committee Operations

Opinions are now developed by small, 3 to 5 man committees of the Board. This permits: (a) heavier concentration by a few; (b) the concurrent development of numerous Opinions and; (c) results in much heavier time commitments by Board members.

Recently we have placed non-Board members on committees so that members' time can be spread further.

3. Advisors

A majority of members have involved partners as advisors. Advisors attend both full Board and committee meetings with or for members, help with the mountain of homework that must be done between meetings, and are members in their own right of some committees.

Many Board members have involved additional partners and professional staff in numerous Board projects, particularly when they are acting as committee chairmen.

4. Opinion Development Procedures

The use of carefully developed point outlines and questionnaires was initiated 4 or 5 years ago. They help identify the more important facets of each project and facilitate meaningful decisions by committees, the full Board, and others.

5. Stepped-Up Pace

There has been an ever-increasing tempo in the Board's activities. In the initial years the Board met, I understand, 2 to 3 times per year for several days each. This increased soon to 5 or 6 times per year for 2 or 2-1/2 days each. For the past several years the Board has had 8 meetings per year, a number of which have gone 4 full days. Many a day has started at 8:00 a. m. and finished at 7:00 p. m. and one went to 10:30 p. m.

6. Membership

The Board's membership has been reduced from 21 to 18. Presumably this was intended to cut full Board discussion time, as it was

recommended six years ago, when the Board had no subcommittees. Those additional members, under our present mode of operations, would be very helpful.

7. Increased Staff Support

Initial staff support, 10 years ago, consisted of 2 men in research.

Today this has been increased to:

6 Professional and 4 clerical staff in research.

5 Professional and 3 clerical staff in administrative support.

Included in this support is one staff member who is engaged in writing unofficial interpretations of Opinions.

In addition, the assistance of the Institute's Executive Vice President has been invaluable. He has filled a void that few of us knew existed. However, there is need for considerable additional staff support.

8. Involvement of Other Groups

As the result of a program started several years ago, we have been able to involve other groups to a much greater degree in our deliberations. For example:

1. The Financial Executives Institute (FEI) has a committee on Corporate Financial Reporting that is somewhat comparable to our Board. They have appointed subcommittees that parallel ours on each project in which they are interested.

2. The Financial Analyst Federation (representing stockholder users of financial statements) and the Robert Morris Associates (representing the credit grantor users of financial statements) have structured themselves somewhat similarly to the FEI.
3. Other groups such as National Association of Accountants (NAA), the American Accounting Association, the Investment Bankers Association, the stock exchanges, the American Bar Association, the American Bankers Association, the American Petroleum Institute and many other groups have expressed a keen interest in the work of the Board, and want - in varying degrees - a piece of the action.
4. The SEC has always been directly interested in our deliberations and there has been continuing close cooperation with them.
5. All of these interested groups are receiving point outlines and questionnaires, used by committees of the Board in developing the foundations for Opinions, and their answers and viewpoints are being considered along with those of Board members.
6. Conferences or symposiums of representatives of all interested groups have been held during the development of recent opinions. The interplay of their divergent ideas and viewpoints has been helpful to each in understanding the problems of the others.

7. Several of the other groups including the FEI and NAA have initiated research on areas under Board consideration.
8. There appeared to be a general consensus, at least prior to the recent exposure of the draft on business combinations, that the APB should be the body to make final decisions and issue opinions. I now sense some questioning of this position by industry.
9. Each group, however, has expressed a desire to be heard early in our deliberations. This will extend somewhat the time it takes to develop opinions but should be well worth the effort.

To me, this history of change in the APB's organization and procedures, indicates an ability to adapt to new conditions. Now, let's analyze current problems facing the Board, with possible solutions.

CURRENT PROBLEMS OF THE BOARD

What follows are not my ideas alone. It should be of some assurance to you to know that the APB's progress and its procedures are under constant consideration by your Board of Directors. In the last 3 years, two ad hoc committees of your Board of Directors have made separate reviews of APB operations. During that time, the APB itself has had two committees reviewing its operations in an effort to increase overall effectiveness.

Our present committee's written recommendations were reviewed by the APB last Thursday and Friday. More work will be done by our committee and a written report will then be made to your Board of Directors.

Now let's turn to a few specific problem areas:

1. Research

We have never been able to realize as much support from research studies as was initially expected. Ready answers to knotty problems just do not seem to roll forth. Possibly our initial expectations were unrealistic.

The research studies that have been started, whether they were assigned in-house, to CPA firms or to academicians, all have taken much longer than originally planned. This forces changes in our long range scheduling and has meant, in some instances, the development of Opinions before complete research.

I am not being as critical of our research division as I may sound. They, particularly the director, have been of invaluable help in developing, writing and rewriting a number of Opinions and Board Statements. Filling the Board's needs in this area has delayed, of course, progress in their regular work.

There are current plans for expanding this effort. It will take a greater commitment of funds and manpower, as well as some changes. Our committee has suggested:

- a. Increasing the full-time paid staff.
- b. Borrowing experienced men from accounting firms and industry for one or two year terms.

- c. Greater use of researchers in the academic field for the more theoretical studies.
- d. Financial support from outside the profession.

2. Board Manpower

I don't believe that much more time can be wrung from our Board members. They probably are close to the breaking point now. Several suggestions have been made and I'll cover each briefly:

- a. Increase membership back to 21. This was mentioned earlier and I favor it, as it would increase the total capacity of Board committees, which represents our capacity to develop Opinions.
- b. Create an advisory (non-voting) membership. I hope that serious consideration will be given to establishing a limited number of non-voting memberships (3 to 8 for example although this would be dependent upon the decision in a. above). These would be available to qualified CPA's who could afford to contribute as much time as full members. This would afford increased capacity in the Board and would broaden the number of firms directly involved in Board matters.
- c. Drafting talent. Much of the drafting is done by Board members. Some make good authors but others do not. Their writing styles are different. AICPA staff drafting talent is being built and more is being sought. This skill is not easily found, so if any of you have leads, see Len Savoie.

- d. Full time, paid Board. Several have suggested that we change to a 5 to 7 man full time, paid Board. I do not favor this for a number of reasons involving initial quality of members, maintenance of quality of members, lack of involvement of and commitment by firms handling publicly held clients, etc. Also, I do not think it would help the overall manpower problem as I believe the present Board logs well in excess of 5 to 7 man years per year.
- e. Full time paid Board Chairman. This suggestion has been considered and endorsed by our committee that is reviewing Board operations. It has been discussed by the full Board and is favored by an ample majority, if the right man can be found. That man would have to be of such a stature that (1) the present semi-independent, quasi-public nature of the Board would be maintained, but (2) he would not represent any competitive threat to key AICPA staff.

3. Board's Voting Rule

As chairman, I have found the 2/3rds majority voting requirement to be most vexing. Our present age of challenge and dissent seems to have rubbed off on the 18 of us just enough to result in many 11 to 7 votes. It doesn't matter that the dissenters may be on completely opposite sides;

some of them wanting more of whatever it is we are trying to do and the rest of them wanting less.

The 2/3rds rule, I am sure, was designed as a safety factor to force continued consideration of each matter until a substantial majority were sure that the best solution had been found. This has been the result in a few cases.

The greater probability is that the voting rule forces compromises that leave very few completely satisfied, and represents poorer answers, at least from the standpoint of the majority. If the changes being sought by the APB can be identified with improvements in accounting principles, and I certainly hope this is so, it is those who seek change who are generally forced to compromise downward to obtain the greatest improvement possible. To them, the alternative is no change at all.

While the effect of our voting rule on the quality of the Opinions is of greater importance, a by-product of the rule is to increase substantially the time it takes to issue an Opinion.

I believe this rule should be considered very carefully and its effect on past Opinions studied.

4. Quality of Opinions

We have been criticized for writing cookbook Opinions by some, and for not including enough guidelines by others. While these two criticisms sound contradictory, probably both are legitimate to a degree.

I believe our opinions will continue to appear complicated, although some simplification will be possible. Procedures for covering many Opinion details in unofficial interpretations have been worked out in the Board's Administrative Director's office. Our first attempt in this area will be a pamphlet of 100 interpretations of the Earnings Per Share Opinion. Here again, I am sure we will learn from experience and will improve this effort as we go. When reasonably perfected, the unofficial interpretations will be included in the CCH loose leaf service.

Another move that I believe would improve the overall quality of our Opinions is to appoint one Board member who has experience as a professional user of financial statements. A CPA member of the Financial Analysts Federation should make a good candidate.

Many believe that the lengthy written dissents by individual members of the Board detract from the Opinions and are a disservice to the profession. This view is concurred in by a majority of our committee on operations and is shared, I believe, by a majority of your Board of Directors. A majority of the APB members, however, do not favor eliminating the dissents. I hope this matter will continue to be studied and that we can eliminate dissents eventually from the printed opinions. Possibly dissents can be carefully drafted and made part of the unpublished but public records of the Board.

5. Need for Quick Decisions

The Board was conceived and created to develop Opinions deliberately, generally after research, with public exposure and under definite rules for balloting. There just is nothing hasty about this process.

However, because the profession has taken the lead in developing improved standards of financial reporting, we are finding it increasingly necessary to consider emergency action. Both the SEC and stock exchanges check our attitude towards a practice they believe objectionable, particularly when they know the practice is under study by the Board. These emergencies usually are fielded initially by the Institute's Executive Vice President.

It would be easy to tell the SEC that we should not be solving their problems. However, their requests are, in my opinion, legitimate attempts to cooperate with the profession in its effort to establish standards.

We have used several procedures to cope with the need for relatively quick decisions:

- (a) On a number of occasions, the matter for decision was already under consideration by an AICPA industry or audit guide committee. If that committee had reached a conclusion on the matter in question, their position was then reviewed quickly but unofficially by all or a majority of APB members. The APB chairman then has permitted the publication of that committee's position. This procedure does not represent an APB pronouncement but does afford sufficient authoritative support for the SEC.
- (b) On two occasions, articles in the Journal of Accountancy have been reviewed in advance, again unofficially, by a majority of APB members and an understanding established that the SEC and the profession would follow the method or principles prescribed in the Journal.

6. Early Warning System

Board members are asked periodically for a list of developing problems they think the APB should be considering. This should act as an early warning system but it has not been too effective. In other words, we need a better system for spotting trouble areas well before they are introduced in the financial press.

This should not be too difficult as firms of the APB members audit the great majority of publicly held clients. An Early Warning Committee is needed.

A PROBLEM FOR THE ENTIRE PROFESSION

These are the current problems of the APB as I see them (research, manpower, the voting rule, quality, the quick decision problem, and an early warning system).

Now I would like to turn to one last matter that I believe is more important than the APB's effectiveness. No matter how fast and how well the APB does its job, it cannot become the conscience of each of us as auditors. It cannot relieve us of the really tough auditing decisions that we should be making.

Everyone of us knows when a client is reaching for earnings. Do we help him in his quest for "legitimate" corners to cut? By "legitimate" I mean those gaps in GAAP (generally accepted accounting principles), the most favorable of alternatives that are still open. Do we ignore the immaterial items incorrectly treated, that add a few cents here and there to earnings per share?

Or do we operate on a higher plane, and insist on the generally accepted accounting principle most applicable in the circumstances? Do we hold our ground when the client threatens to change to auditors who are "more reasonable"? And if we are those other auditors, what do we do when we are being "shopped" for an easier way, a more liberal alternative, but one that is still acceptable.

The answers that we should be giving to the above questions are obvious. However, I have heard many fine accountants say that we cannot deny a client the use of any generally accepted accounting principle, regardless of the circumstances.

This just shouldn't be so; we must concentrate on raising our sights!

CONCLUSION

In conclusion, I'll get back to my own side of the fence, the APB. While it may seem slow in coming, real progress is being made and will continue to be made, particularly if we can get the responsible assistance of the other groups. I say this, even though there are some who would still seem to cling to the status quo.

For those who cry for more action, we will do the best we can. However, I think it is unrealistic to expect the APB, or any other group, to solve problems in a few years that have defied solutions for decades.

There will be considerable progress in the next 10 years. While we may never be completely satisfied with the results of our efforts, the APB and the entire profession, I am convinced, will be able to cope with this fast changing, dynamic, but imperfect world of ours.
