Accounting and auditing developments, 1980: December 1979 through December 1980

Touche Ross & Co.
ACCOUNTING AND AUDITING DEVELOPMENTS 1980

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FOREWORD

Accounting and Auditing Developments – December 1979 through December 1980 – summarizes most of the authoritative pronouncements that have been issued during that period, as well as a number of information releases that address issues of current interest. The summaries have been prepared primarily to remind our clients and staff of recent developments affecting financial accounting and reporting, and should not be considered definitive or complete. The source documents themselves should be consulted to determine detailed requirements. In addition, because accounting and auditing information is changing continually, often with little advance notice, we urge clients to contact their Touche Ross account executive to be sure that the information at hand is the latest available.

The material in this booklet is arranged according to the issuer of the pronouncement, that is, the FASB, the AICPA, the SEC or other rule making body. However, there are situations where one issue is addressed by more than one organization; changing prices information, for example, is the subject of releases by both the FASB and the AICPA. Thus, we have included, at the end of this booklet, a topical index to aid the reader in finding all the summaries on a given subject.

Additional copies of this booklet are available on request from:

Library
Touche Ross & Co.
1633 Broadway
New York, New York 10019

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FINANCIAL ACCOUNTING STANDARDS BOARD

STATEMENTS OF FINANCIAL ACCOUNTING STANDARDS

SFAS No. 35, Accounting and Reporting by Defined Benefit Pension Plans, establishes financial accounting and reporting standards for the external financial statements of defined benefit pension plans. The standards apply to plans in the private sector as well as those sponsored by state and local governments. The Statement does not require the preparation, distribution or attestation of financial statements for any plan.

The Statement indicates that the primary objective of plan financial statements is to provide information useful in assessing the plan’s present and future ability to pay benefits when due. To accomplish that objective, the plan’s financial statements should include information regarding:

a. net assets available for benefits as of the end of the plan year
b. the changes during the year in net assets available for benefits
c. the actuarial present value of accumulated plan benefits (plan obligations) as of either the beginning or the end of the plan year
d. the effects, if significant, of certain factors affecting the year-to-year change in the actuarial present value of accumulated plan benefits.

Although earlier application is encouraged, this Statement is effective for plan years beginning after December 15, 1980.

SFAS No. 36, Disclosure of Pension Information – an amendment of APB Opinion No. 8, Accounting for the Cost of Pension Plans, requires revised disclosures about defined benefit pension plans in employers' financial statements.

The FASB states that SFAS No. 36 is but an interim improvement in pension disclosures – an ongoing project on all aspects of employer accounting for pensions and related benefits, expected to be completed in 1982, will establish comprehensive accounting and reporting requirements. SFAS 36 is effective for annual financial statements for fiscal years beginning after December 15, 1979, and for complete sets of financial statements for interim periods within those fiscal years issued after June 30, 1980. Employers are required to disclose certain data determined in accordance with SFAS 35 (Accounting and Reporting by Defined Benefit Pension Plans).
SFAS No. 37, Balance Sheet Classification of Deferred Income Taxes – an amendment of APB Opinion No. 11, Accounting for Income Taxes, clarifies the classification when there is no asset or liability in the balance sheet related to the timing difference. The Statement indicates that deferred income taxes that are related to an asset or liability should be classified the same as the related asset or liability. Deferred income taxes that are not related to an asset or liability should be classified according to the expected reversal date of the timing difference.

The SFAS provides examples of balance sheet classification of certain types of deferred income taxes.

Also, the SFAS states that "stock relief" under SFAS No. 31, Accounting for Tax Benefits Related to U.K. Tax Legislation Concerning Stock Relief, is not a timing difference. Accordingly, those tax benefits should be classified the same as other liabilities based on the period of potential recapture.

The Statement is effective for financial statements for periods ending after December 15, 1980, with earlier application encouraged. Reclassification in previously issued financial statements is permitted but not required.

SFAS No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises – an amendment of APB Opinion No. 16, specifies accounting for contingencies in existence at the purchase date of an enterprise.

Amounts which can be reasonably estimated for contingencies that are considered probable would be recorded as a part of the allocation of the purchase price. Subsequent adjustments would be included in the determination of net income in the period in which the adjustments are determined. An exception to this will be adjustments which result from realized income tax benefits of preacquisition operating loss carryforwards.

The deciding factor as to whether the contingency is recorded as part of the allocation of the purchase price or in the determination of net income of a period subsequent to the purchase date is whether the information necessary to resolve the contingency becomes available in the "allocation period" or not. This period ends when the acquiring enterprise is no longer waiting for information that it has arranged to obtain and that is known to be available or obtainable. Although this time period will vary with circumstances, it will not usually exceed one year from the consummation of the business combination.

The amendment is to be effective for business combinations initiated after December 15, 1980. Earlier application is encouraged for financial statements not previously issued. If the initial recording of a preacquisition contingency was not in accordance with the Statement
and that contingency has not been finally resolved prior to the effective date of the Statement, the provisions of the Statement may be applied retroactively. Otherwise, the Statement may not be retroactively applied.

**SFAS Nos. 39, 40 and 41**, all entitled Financial Reporting and Changing Prices: Specialized Assets – a supplement to FASB Statement No. 33, establishes requirements for the measurement and disclosure of information about certain specialized assets:

- Mining and oil and gas (SFAS No. 39),
- Timberlands and growing timber (SFAS No. 40),
- Income-producing real estate property (SFAS No. 41).

The main provisions of the Statements are:

- The general guidelines of Statement 33 for measuring on a current cost basis: (a) income from continuing operations; (b) amounts of inventory, property, plant, and equipment; and (c) increases of decreases in amounts of inventory, property, plant, and equipment, net of inflation, are applicable to specialized assets.
- Enterprises shall disclose the estimated fair values of timberlands and growing timber, oil and gas proved reserves, and income-producing real estate properties. Those fair values shall be reported separately from the measurements of other assets stated at current cost.
- Enterprises are required to present a reconciliation of beginning and end-of-year fair values of proved oil and gas reserves.
- Income before unallocated expenses, as measured in both the primary financial statements and on a current cost basis, shall be separately disclosed for an oil and gas producing segment.
- Information about quantities of mineral reserves, production and prices is required for enterprises with mining assets.

Examples of disclosures are illustrated in an appendix to the Statement. All three are effective for fiscal years ended on or after December 25, 1980.

**SFAS No. 42, Determining Materiality For Capitalization of Interest Cost – an amendment of FASB Statement No. 34**, deletes language that some believe allows capitalization of interest to be avoided under certain circumstances and 2) make clear that the usual tests of materiality apply for implementing SFAS No. 34.

The Statement is effective for fiscal years beginning after December 15, 1979. Companies that have previously adopted SFAS No. 34 shall apply this Statement in their next fiscal year beginning after October 15, 1980 and may, but are not required to, restate their financial statements for the year of initial adoption to reflect the provisions of the Statement.
SFAS No. 43, Accounting for Compensated Absences, requires employers to accrue the costs of compensated absences on a current basis when all of the following conditions are met:

a. The employer’s obligation relating to employee’s rights to receive compensation for future absences is attributable to that employee’s services already rendered
b. The obligation relates to rights that vest or accumulate
c. Payment of the compensation is probable, and
d. The amount can be reasonably estimated.

Such absences include vacation, holidays, illness or other personal activities for which it is expected that an employee will be paid. Not included are severance or termination pay, post-retirement benefits, deferred compensation, stock or stock options issued to employees, or other long-term fringe benefits (e.g., group insurance, long-term disability pay) or absences due to an employee’s illness.

The Statement is effective for fiscal years beginning after December 15, 1980. Earlier application is encouraged and retroactive application is required.

SFAS No. 44, Accounting for Intangible Assets of Motor Carriers – an amendment of Chapter 5 of ARB No. 43 and an Interpretation of APB Opinions 17 and 30, requires that the unamortized costs of operating rights be charged to income and, if material, reported as an extraordinary item. The Statement does not affect the accounting for other intangible assets of motor carriers, such as goodwill. The Statement was issued because passage of the Motor Carrier Act of 1980, which deregulated interstate trucking, reduced or eliminated the value of trucking companies’ exclusive rights to transport goods. SFAS No. 44 is effective for financial statements for fiscal years ending after December 15, 1980.

INTERPRETATIONS

FASB Interpretation No. 31, Treatment of Stock Compensation Plans in EPS Computations, interpreting APB Opinion No. 15 and modifying SFAS No. 28, clarifies the definition of funds obtained from the assumed exercise of stock options, including stock appreciation rights and other variable plan awards, for purposes of applying the treasury stock method of computation. According to the Interpretation, the exercise proceeds of the options are the sum of the amount the employee must pay plus the amount of measurable compensation ascribed to future services and not yet charged to expense (whether or not accrued) and any “windfall” tax benefit. The Interpretation is effective for fiscal years beginning after December 15, 1979. Earlier application is encouraged and retroactive application is permitted.
FASB Interpretation No. 32, Application of Percentage Limitations in Recognizing Investment Tax Credit, interpreting APB Opinions 2, 4 and 11, clarifies paragraph 10 of FASB Interpretation No. 25, Accounting for an Unused Investment Tax Credit. The Interpretation allows looking to the limitation percentage in effect in the year in which the net deferred tax credits reverse, but only if the net deferred tax credits in question have not previously been offset at a lower rate. Deferred tax credits offset in prior years may not be adjusted to reflect changes in the limitation percentage.

The Interpretation shall be applied prospectively in fiscal years beginning after December 15, 1979, with earlier application encouraged in financial statements for fiscal years beginning before December 16, 1979, which have not been previously issued. The Interpretation is not be be applied retroactively for previously issued annual financial statements.

FASB Interpretation No. 33, Applying FASB Statement No. 34 to Oil and Gas Producing Operations Accounted for by the Full Cost Method, an interpretation of FASB Statement No. 34, clarifies which assets of oil and gas producers using the full cost method qualify for interest capitalization. In summary, qualifying assets are a) those unusually significant investments in improved properties and major development projects that are not being depreciated, depleted or amortized currently and b) significant properties and projects in cost centers with no production, provided that the exploration or development activities on the assets in a) and b) are in progress. The Interpretation is effective for financial statements for fiscal years beginning after December 15, 1979 and for interim periods within those years. If SFAS No. 34 has already been applied in previously issued financials in a way different from that prescribed in the Interpretation, a number of restatement provisions or "as if" disclosures are required.

STATEMENTS OF FINANCIAL ACCOUNTING CONCEPTS

SFAC No. 2, Qualitative Characteristics of Accounting Information, is the latest release in the FASB’s conceptual framework project. Having established the objectives of financial reporting in the first concepts statement, the Board now progresses to definition and exposition of what it sees as the keystones of decision making based on financial reports.

Choosing from among available alternatives of accounting choice, the Board has agreed that the following qualitative characteristics, as defined, are the most useful to investors, creditors, and similar parties in making their decisions (two constraints are recognized: the information must be cost/beneficial and material):

Relevance – the capacity of information to make a difference in a decision by helping users to form predictions about the outcomes of past, present and future events or to confirm or correct prior expectations.


Reliability – the quality of information that assures that information is reasonably free from error and bias and faithfully represents what it purports to represent.

Comparability and consistency – the qualities of information that enable users to identify similarities in and differences between two sets of economic phenomena, conforming from period to period with unchanging policies and procedures.

The Statement explains in detail a hierarchy of qualities that together make up these principal qualitative characteristics.

SFAC No. 3, Elements of Financial Statements of Business Enterprises, is a major effort by the Board to establish definitions of 10 key elements of financial statements. The elements defined are two kinds: assets, liabilities and equity describe levels or amounts of resources or claims to resources, at a given moment, while all other elements describe effects of transactions and other events and circumstances that change assets, liabilities and equity during periods of time – they include comprehensive income and its components (revenues, expenses, gains and losses), as well as investments by owners and distributions to owners.

SFAC No. 4, Objectives of Financial Reporting by Nonbusiness Organizations, specifies that nonbusiness financial reporting should provide information that is useful to resource providers in making decisions about allocation of resources; in assessing the services an organization provides and its ability to continue to provide those services; and in assessing how managers of an organization have discharged their stewardship responsibilities. Until the standard-setting structure for state and local government units is established, SFAC No. 2 would not necessarily apply to those organizations. However, either this Statement or SFAC No. 1 Objectives of Financial Reporting by Business Enterprises should, according to the Board, apply to such government-sponsored entities as hospitals, universities and utilities engaged in activities that are not unique to government.

TECHNICAL BULLETINS

The Financial Accounting Standards Board has authorized its staff to issue a new type of release called FASB Technical Bulletins. These Bulletins usually address financial accounting and reporting matters of limited interest or of a specific application – they deal with questions that may arise as to the application of FASB pronouncements, APB Opinions or Accounting Research Bulletins. FASB Technical Bulletins do not establish new accounting and reporting standards nor do they amend existing standards. The Bulletins replace the letter communications that were formerly summarized in the Board's Status Report.
TB No. 79-1, Purpose and Scope of FASB Technical Bulletins and Procedures for Issuance, explains why FASB TBs have been adopted, the Board’s degree of involvement (Board members know of matters proposed for TBs, but do not approve issuance) and the guidelines that a proposed TB must meet before it may be issued.

TB No. 79-2, Computer Software Costs, states that even though software production costs have been determined not to be research and developments costs, as defined in SFAS No. 2, it does not necessarily follow that they would be inventoriable or deferrable to future operations — such decisions must depend on the facts in each given situation.

TB No. 79-3, Subjective Acceleration Clauses in Long-term Debt Agreements, indicates that the mere existence of such clauses does not mean that the related debt has to be classified as current. In fact, it is not always necessary even to disclose the existence of the clause. Each situation should be judged on its own merits — the past practices of the lender, the strength of the borrower, etc.

TB No. 79-4, Segment Reporting of Puerto Rican Operations, indicates that the relationship between the U.S. and Puerto Rico (as well as other dependent U.S. territories) is such that Puerto Rican operations of U.S. enterprises are considered domestic operations and need not be segmented. However, other disclosures about Puerto Rican operations that might be helpful are not prohibited by SFAS No. 14.

TB No. 79-5, Meaning of the Term “Customer” as It Applies to Health Care Facilities under FASB Statement No. 14, expresses the staff’s belief that group insurers (such as Blue Cross) are not customers of health care facilities, and thus need not be segmented in a hospital’s financial statements under the 10% rule. A “customer” is one who decides which services to purchase and from which institution; group insurers do not do that and, therefore, are not customers.

TB No. 79-6, Valuation Allowances Following Debt Restructuring, states that the collectibility of a receivable whose terms and carrying basis have been changed as a result of a restructuring under SFAS No. 15 must be evaluated to determine whether a subsequent valuation allowance would be required under SFAS No. 5 (contingencies).

TB No. 79-7, Recoveries of a Previous Write-down under a Troubled Debt Restructuring Involving a Modification of Terms, says that a creditor may not reverse such a write-down, even if the future cash receipts exceed the recorded investment in the receivable — those receipts should be accounted for as interest income. And disclosure of the amount and source of the interest income is permitted.
TB No. 79-8, Applicability of FASB Statements 21 and 33 to Certain Brokers and Dealers in Securities, maintains that those broker/dealers who file financial statements with the SEC only for regulatory purposes (i.e., all financials but the statement of financial condition may be filed as confidential) are nonpublic enterprises; therefore, the suspension of EPS and segment reporting requirements of SFAS No. 21 applies to those broker/dealers, and they are excluded from the reporting requirements of SFAS No. 33.

TB No. 79-9, Accounting in Interim Periods for Changes in Income Tax Rates, indicates that, when such changes occur (e.g., as a result of the Revenue Act of 1978), the effective tax rate should be recalculated and applied to pretax income for the year-to-date at the end of the current interim period. If the effect is material, previous interim periods in the current fiscal year would have to be restated.

TB No. 79-10, Fiscal Funding Clauses in Lease Agreements, discusses the question of whether such clauses, usually encountered when the lessee is a governmental unit, would require that a lease be deemed cancelable and, therefore, classified as an operating lease under SFAS No. 13. The FASB staff believes that, if assessment of the lease agreement indicates that the likelihood of the exercise of the fiscal funding clause is remote, the lease would be considered noncancelable.

TB No. 79-11, Effect of a Penalty on the Term of a Lease, states that the lease term must include any periods in which a penalty could be assessed if the lease is not renewed, provided that at the inception of the lease the existence of the penalty is known and the nature and amount of the penalty would appear to assure renewal.

TB No. 79-12, Interest Rate Used in Calculating the Present Value of Minimum Lease Payments, says that SFAS No. 13 does not proscribe the lessee’s use of its secured borrowing rate as its incremental borrowing rate.

TB No. 79-13, Applicability of FASB Statement No. 13 to Current Value Financial Statements, states that SFAS No. 13 would not be inapplicable merely because financial statements are prepared on a current value basis.

TB No. 79-14, Upward Adjustment of Guaranteed Residual Value, points out that such adjustment would be prohibited by SFAS No. 13.

TB No. 79-15, Accounting for Loss on a Sublease Not Involving the Disposal of a Segment, states that the general principles for loss recognition should be followed.

TB No. 79-16 (Revised), Effect of a Change in Income Tax Rate on the Accounting for Leveraged Leases, states that a change in lessor’s income
tax rate should be recognized in the period in which the change occurs. Moreover, if there is a significant variation between book income and tax income, the reason for the variation would have to be disclosed under APB Opinion No. 11.

TB No. 79-17, Reporting Cumulative Effect Adjustment from Retroactive Application of FASB Statement No. 13, states that the cumulative effect would not be included in the net income of any period presented unless the year prior to the earliest year presented could not be restated.

TB No. 79-18, Transition Requirement of Certain FASB Amendments and Interpretations of FASB Statement No. 13, clarifies the meaning of the term "have published annual financial statements" in effective date paragraphs for SFAS No. 13 amendments and interpretations. Generally, the term refers to the financial statements that are included in the company’s normal annual report to shareholders.

TB No. 79-19, Investor's Accounting for Unrealized Losses on Marketable Equity Securities Owned by an Equity Method Investee, says that the investor (or parent) must reduce its investment in the investee or subsidiary in proportion to the changes in the valuation allowance, and show that amount in the stockholders' equity section.

TB No. 80-1, Early Extinguishment of Debt through Exchange for Common or Preferred Stock, states that such extinguishments should be accounted for in accordance with either APB Opinion No. 15 (for troubled debt restructurings or APB 16 (for all other early extinguishment).

TB No. 80-2, Classification of Debt Restructurings by Debtors and Creditors, points out that SFAS No. 15 does permit asymmetrical accounting by debtor and creditor in a troubled debt situation, i.e., the debtor may have a troubled debt restructuring even though the related creditor does not. Paragraph 7 of SFAS No. 15 illustrates such accounting treatment.

PRACTICE AIDS

The FASB has published a booklet, Illustrations of Financial Reporting and Changing Prices, that presents examples of how companies in various industries might disclose the constant dollar and current cost information required by SFAS No. 33.

The FASB has issued Accounting for Leases, SFAS No. 13, as amended and interpreted through May 1980. The document incorporates
Statements 13, 17, 22, 23, 26, 27, 28 and 29 and Interpretations 19, 21, 23, 24, 26 and 27. Included in the document is a codification, all original pronouncements, interpretations, FASB Technical Bulletins relative to leases, a cross-reference table and index.

The FASB has issued Examples of the Use of FASB Statement No. 33, Financial Reporting and Changing Prices, which presents illustration of disclosures on the impact of inflation taken from 1979 annual reports.

AICPA – AUDITING STANDARDS BOARD

STATEMENTS ON AUDITING STANDARDS

SAS No. 27, Supplementary Information Required by the Financial Accounting Standards Board, establishes procedures for the measurement and presentation of information that is not part of the basic financial statements. At present, the SAS applies to SFAS No. 33 Changing Prices and SFAS No. 25, Oil and Gas Reserve Quantities. Generally, auditors should query management on the methods used to prepare the supplementary information, the sources of the information and the underlying assumptions. The information would have to be compared for consistency with the basic financial statements. Ordinarily, the auditor would report on the supplementary information only when he has exceptions.

SAS No. 28, Supplementary Information on the Effects of Changing Prices, provides additional guidance regarding inquiries to be made of management under SAS No. 27, Supplementary Information Required by the Financial Accounting Standards Board. SAS No. 27 is a general document and SAS No. 28 addresses procedures with respect to data required under SFAS No. 33, Financial Reporting and Changing Prices. Generally, the auditor should make inquiries of management concerning a) sources of information and appropriateness of their application, b) assumption and judgments and c) the need to reduce inventory or property to a lower recoverable value, if any.

SAS No. 29, Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents, supersedes AU 610, Long-Form Reports and provides guidance in reporting on information other than basic financial statements. The Statement will be effective for auditors’ reports dated on or after December 31, 1980.

SAS No. 30, Reporting on Internal Accounting Control, establishes general procedures when an auditor is engaged to examine and report on
internal accounting control. The SAS provides that the accountant should "... a) plan the scope of the engagement, b) review the design of the system, c) test compliance with prescribed procedures and d) evaluate the results of his review and test." Each of these areas is discussed in the Statement. Examples of the report to be issued are included. Also included is a section, Report on Internal Accounting Control Based Solely on a Study and Evaluation Made as Part of an Audit, as well as a sample report under these circumstances. The Statement also says that FCPA compliance is a legal matter and that an accountant's opinion on a system does not indicate compliance with the Act but may be helpful to management in evaluating compliance.

**SAS No. 31, Evidential Matter,** updates SAS No. 1, Section 330, by adding two new areas, the nature of assertions by management and the use of assertions in developing audit objectives and designing substantive tests. The revisions reflect the growing trend toward risk-based auditing which concentrates, as does our Touche Ross Audit Process, on audit objectives.

**SAS No. 32, Adequacy of Disclosure in Financial Statements,** replaces AU Section 430. The basic concepts in AU 430 are unchanged, but SAS No. 32 establishes consistency with SAS No. 12 Lawyer's Letters, SAS No. 17 Illegal Acts, and SFAS No. 5 Contingencies. Also, the meaning of "practicable" as it pertains to the auditor's responsibility to furnish omitted disclosures is expanded.

**SAS No. 33, Supplementary Oil and Gas Reserve Information,** has been issued after much discussion and revision of the exposure draft. Revisions include an added paragraph concerning the inquiries necessary to meet the SEC's reserve value disclosure requirement, guidance on when the auditor should consider obtaining the assistance of a consulting engineer and an added paragraph commenting on the "softness" of the data. The Statement is to be applied in conjunction with SAS No. 27, which became effective December 25, 1979.

**INTERPRETATIONS**

*Communications between the Auditor and Firm Personnel Responsible for Nonaudit Services* is an interpretation of SAS No. 22, Planning and Supervision, and states that when nonaudit services are performed the auditor should discuss them with the personnel in his firm who rendered the services. He may also wish to review portions of their work papers to determine how the services may have affected the entity's financial statements or the performance of the audit.

*The Auditor's Consideration of Accounting Principles Set Forth in Industry Audit and Accounting Guides* updates SAS No. 5, The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting
"Principles" in the Independent Auditor's Report. This interpretation states that, in expressing an unqualified opinion on financial statements, the auditor has an obligation to consider an applicable AICPA industry accounting and audit guide or statement of position that amends such a guide in concluding whether the financial statements are in conformity with generally accepted accounting principles.

The Effect of FASB Statement No. 34 on Consistency states that a change in accounting principle occurs when an entity adopts the provisions of SFAS No. 34, Capitalization of Interest Cost. Thus, if the change is material, the auditor should give recognition to the inconsistency in his report.

The Effect of FASB Statement No. 31 on Consistency states that the "stock relief" legislation enacted in the United Kingdom in July 1979, when applied to financial statements, does not require the auditor to modify his opinion as to consistency – the interpretation indicates that the lack of comparability brought on by the legislation is caused, not by a change in accounting principle, but by a new event (i.e., the change in the U.K. tax law).

The Effect of Accounting Changes by an Investee on Consistency states that an auditor would need to modify his opinion as to consistency when there has been a change in accounting principle by an investee accounted for by the equity method that causes a material lack of comparability in the financial statements of an investor.

Four of the interpretations deal with SFAS No. 14, Special Reports.

Financial Statements Prepared in Accordance with Accounting Practices Specified in an Agreement states that a basis of accounting specified in an agreement is not a comprehensive basis of accounting as contemplated by SAS No. 14, paragraph 14d. The auditor should modify his report as to the conformity of the special purpose financial statements with GAAP. He may also express an opinion on whether the statements are presented fairly on the basis of accounting specified in the agreement.

Reporting on Special-Purpose Financial Presentations states that certain special-purpose financial presentations that do not constitute a complete presentation of historical financial position or results of operations of an entity generally should be regarded as financial statements. Thus, the auditor should express an opinion on the fairness of the presentation of the information taken as a whole in conformity with GAAP.

Understanding of Agreed-upon Procedures describes the steps the accountant may take when he is not able to discuss the procedures directly with all of the parties who will receive a special report on the results of applying agreed-upon procedures.
Adequacy of Disclosure in Financial Statements Prepared on a Comprehensive Basis of Accounting Other than Generally Accepted Accounting Principles states that when financial statements prepared on another comprehensive basis of accounting contain items that are the same as, or similar to, those in financial statements prepared in conformity with GAAP, the same degree of informative disclosures is generally appropriate. The auditor should also consider disclosing other material matters.

Five interpretations of reports on internal accounting control were issued; the first four concern reports in connection with a government grant.

Pre-Award Surveys gives the sample report that should be used in connection with these engagements, which are not audits.

Award Survey Made in Conjunction With an Audit gives guidance when an award survey is made in connection with an audit.

Reporting on Matters Not Covered by Government-Established Criteria states that negative assurance should not be given in a pre-award survey.

Limited Scope Survey modifies a previous interpretation giving guidance on reporting on internal control when part of the examination encompasses a delegate agency which, by the terms of the engagement, is not audited.

Compliance with the Foreign Corrupt Practices Act states that an auditor cannot give comfort or indicate compliance with the FCPA, but a report may be useful to companies in assessing their compliance.

Description in a Prospectus When an Accountant’s Report Based on a Review of Interim Financial Information Is Included in a 1933 Act Filing gives guidance to an accountant in determining whether a description referring to experts in a prospectus satisfactorily states the status of the accountant’s report based on a review of interim financial information that is included in a filing under the 1933 Act.

The Effect of Adoption of SFAS No. 35 on Consistency states that the Adoption of SFAS No. 35 may result in a change in accounting principles requiring reference in the auditors’ report but that a change in benefit information required to be presented is not such a change. The effective date of the interpretation is plan years beginning after December 15, 1980.
Changes in Presentation of Accumulated Benefit Information – the Financial Statements of a Defined Benefit Pension Plan states that changes in presentation, including format and date, relating to accumulated benefits should be explained in a financial statements note. Further, this change would not ordinarily require recognition in the auditors’ opinion as to consistency.

The Effect of Adoption of SFAS No. 36 on Consistency states that the required additional data does not constitute a change requiring reference as to consistency in the auditors’ opinion.

AICPA – ACCOUNTING AND REVIEW SERVICES COMMITTEE

STATEMENTS OF STANDARDS ON ACCOUNTING AND REVIEW SERVICES

None Issued.

INTERPRETATIONS

Five interpretations of SSARS Nos. 1 and 2 have been published.

Omission of Disclosures in Reviewed Financial Statements requires an accountant who has undertaken a review engagement, in which the client subsequently decides to omit substantially all disclosures required by GAAP, to include in his review report the disclosures omitted. If the specific information is not known, or has not been determined by management, the accountant should specifically identify the nature of the omitted disclosure.

Financial Statements Included in SEC Filings notes that it is a matter of professional judgment whether SSARS No. 1 would apply to the report on a nonpublic entity’s unaudited financial statements included in documents filed with the SEC. It includes a discussion of matters the accountant should consider in reaching his professional opinion.

Reporting on Highest Level Service deals with the question of reporting on the highest level of service through a series of illustrative cases.

Discovery of Information after the Date of the Accountants’ Report outlines the factors which an accountant ordinarily would consider in determining a course of action when he becomes aware, subsequent to his report on compiled or reviewed financial statements, that facts may have existed at that date which might have caused him to believe that data supplied by the entity was unsatisfactory.
Reporting on Financial Statements that Previously Did Not Omit Substantially All Disclosures deals with circumstances when an accountant has compiled, reviewed or audited financial statements that do not omit substantially all of the disclosures required by GAAP and may subsequently compile financial statements for the same period that do omit substantially all the disclosures when they are presented in comparative financial statements.

AICPA – ACCOUNTING STANDARDS DIVISION

STATEMENTS OF POSITION

SOP 80-1, Accounting for Title Insurance Companies, narrows many of the diverse accounting practices in the industry. Premium revenue is to be recognized as earned when the company is entitled to collect the premium; estimated losses should be recognized at the time the related premium revenue is recognized; loss adjustment expenses for outside services should be accrued; and the title plant is to be accounted for using the same GAAP as for other tangible assets. The SOP should be applied to financial statements for fiscal years beginning after December 31, 1980, with earlier application encouraged; prior periods should be restated.

SOP 80-2, Accounting and Financial Reporting by Governmental Units, amends the 1974 AICPA audit guide, Audits of State and Local Governmental Units. The amendments recognize Statement 1 of the National Council on Governmental Accounting, entitled Governmental Accounting and Financial Reporting Principles, issued to reorder and replace GAAFR. The SOP recognizes that financial statements prepared in accordance with Statement 1 are in conformity with generally accepted accounting principles.

The SOP describes the basic general purpose financial statements of a state or local governmental unit and offers guidance on the type of auditor’s report to be issued on a complete set of governmental unit financial statements or specific combinations of fund or account group financials. Several examples of auditor’s reports are presented in the appendices to the SOP.

AICPA – COMMITTEES

Conclusions and Recommendations of the Special Advisory Committee on Reports by Management, backs the Cohen Commission’s recommendation that management is responsible for the financial statements. The Committee’s final report discusses and provides illustrative examples of management representations pertinent to:
management's assumption of responsibility for financial statements; management's statement of reasonable assurance as to the company's internal accounting controls; and description of the roles of the audit committee and the independent auditor.

AICPA – PRACTICE AIDS

AICPA Financial Report Survey 20, Illustrations of Selected Proxy Information – A Survey of the Application of SEC Requirements to Disclose Auditors' Services and Management Perquisites in Proxy Statements, contains examples, taken from proxy statements, of disclosures of auditors' services and management perquisites in accordance with SEC rules. The survey consists of two parts:

1. Auditors' Services – showing individual disclosures by percentage range of nonaudit fees, and
2. Management Perquisites – showing individual disclosures by type of perquisite.

The appendices contain extracts of the SEC Releases and Staff Accounting Bulletins that set forth the disclosure requirements.

AICPA Financial Report Survey 21, Illustrations of Accounting for Joint Ventures, contains examples, taken from financial statements, of various methods of accounting for joint ventures. The survey is divided into three parts:

1. The Equity Method
2. Consolidation

The appendices in the Survey contain excerpts from APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, and SOP 78-9, Accounting for Investments in Real Estate Ventures, both of which address certain aspects of accounting for joint ventures.

In general, any of the illustrations in Financial Report Surveys being considered as models should be carefully reviewed, since the examples often illustrate specific points and may not always include the complete disclosures required by GAAP or GAAS.
SECURITIES AND EXCHANGE COMMISSION

ACCOUNTING SERIES RELEASES*

ASR 274, Accountant Liability for Reports on Unaudited Interim Financial Information Under Securities Act of 1933, excludes accountants from liability under Section 11(a) (material misstatements or omissions in registration statements) for issuing reports on reviews of interim financial data, i.e., "SAS 24-type" reviews. The SEC hopes that its action will encourage greater auditor involvement with interim financial information.

A prospectus that discusses the accountant's involvement with a registration statement should state that Section 11 liability does not extend to the accountant's report on the interim review (of course, accountants remain potentially liable under other statutes and rules, e.g., Rule 10b-5 of the 1934 Act).

ASR No. 276, Bank Holding Companies and Banks - Requirements for Form and Content of Financial Statements, revises certain specific disclosure requirements regarding loans to nonofficer-directors and reporting of large certificates of deposit and time deposits.

ASR No. 277, Oil and Gas Reserve Information - Postponement of Audit Requirement, states that, until a final decision is reached on adopting reserve recognition accounting as a uniform method of accounting, the requirement that oil and gas reserve information be audited is postponed. In order to permit reserve information to be presented as supplementary data outside the financial statements Regulation S-X was amended. These amendments are expected to minimize the cost of presenting reserve information and to encourage the disclosure experimentation.

ASR No. 278, Statement of Management on Internal Accounting Control - Withdrawal of Proposed Rules. Although the SEC has considered a mandatory internal control reporting requirement, both for registrants and reports thereon by auditors, in ASR 278 the proposal has been withdrawn. The SEC's decision was based on perceived private sector initiatives for public reporting on internal accounting control, not wanting to preempt these initiatives by government regulation and the very considerable cost that apparently might be involved. The SEC will monitor private sector developments through the spring of 1982, at which time a comprehensive reconsideration will be given to the subject.

*Does not include Accounting Series Releases dealing with administrative matters
ASR 278 also provides guidance for the private sector development of approaches to public reporting on internal accounting control.

In **ASRs No. 279, 280 and 281**, the SEC has adopted major revisions to Form 10-K and Regulation S-X and has issued new Uniform Instructions as to Financial Statements in Filings. The changes are substantially as proposed, and most will apply to calendar 1980 year-ends. The key revisions will:

1. Require many filings to contain three years' income statements and changes in financial position and two years' balance sheets, all audited.
2. Permit financial statements from annual reports to be incorporated by reference in Form 10-K. However, financial statements and disclosure requirements in annual reports to shareholders and Form 10-K must be consistent.
3. Revise Articles 3, 5 and 12 of Regulation S-X to make it substantially consistent with GAAP, but there may still be some technical disclosures under S-X that are not required by GAAP.
4. Generally, require the same financial information in most filing documents.
5. Require stub period statements in 1933 Act filings to be at least as timely as the current 10-Q filings and summarized (condensed) the same as in 10-Q.

In addition, the SEC (Release 33-6232) has also approved new Form S-15, a short form registration for a business combination not having a significant impact on the acquiring company. The Form may be used 30 days after the Release appears in the Federal Register.

In related actions (Release 33-6236), proposals to amend Form 10-Q and for three new registration forms – A, B and C – have also been issued. Form A would replace Form S-16 and include considerable incorporation by reference. Form B would provide some option to incorporate by reference. Form C, a streamlined S-1, would allow very little incorporation by reference.

More information will be provided when we have had time to analyze the new rules.

As part of its new disclosure system, the SEC has issued Release 33-6230, which standardizes and improves exhibit requirements. The Release covers the following matters:

1. With the exception of Form S-18, specific exhibit requirements are no longer contained in the selected frequently used forms; instead, a single reference appears to Regulation S-K.
2. Adopts Item 7 of Regulation S-K which contains all of the exhibit requirements for the relevant forms being amended. Item 7
consists of two parts: (a) two tables (one each for the Securities and Exchange Acts) listing each of the forms covered by Item 7 and the exhibits required to be filed with each form, and (b) a definitional section containing a narrative description of each exhibit listed in the tables.

3. Deletes 13 exhibits formerly required to be filed.

4. Revises and makes more uniform the requirements of certain exhibits.

5. For Form S-18, adopts all the substantive changes to the exhibit requirements outlined in the Release but, instead of inserting a reference to Regulation S-K in the Form S-18, the changes are directly incorporated into the “Instructions as to Exhibits” section of that Form.

ASR 284, Technical Amendments to Rules, Forms and Schedules; Delegation of Authority to the Director of the Division of Corporation Finance, is basically an administrative release that “cleans up” Commission regulations that became inconsistent with the rules and regulations adopted in the integrated disclosure system. For example, many items in the general instructions for various forms are changed to refer to the new location of the items in Regulation S-K. Also, in keeping with amendments to the Commission’s rules of organization, the Director of the Division of Corporation Finance may now authorize extensions in filing dates only for certain audited financial statements – applications for extensions for other information, documents or reports under the Exchange Act are no longer required.

STAFF ACCOUNTING BULLETINS

SAB No. 36, Interpretations for Oil and Gas Producers, exempts certain limited partnerships from disclosing in Form 10-K and in registration statements certain reserve information. The SAB also permits Canadian oil and gas producers to follow Canadian GAAP in 10-Ks, as long as the differences are described in a footnote and net income is reconciled to what net income would be following the SEC’s rules.

SAB No. 37, Deletion of Topic 4-F of SAB No. 1, withdraws the format illustration of the stockholder’s equity section of a savings and loan holding company’s balance sheet. The SEC staff has accepted the AICPA’s revised accounting and auditing guide for savings and loan associations, which provides for presentation of that information.

SAB No. 38, SEC Modifies Audit Services Definition for Internal Control Reviews, amends SAB 25 to clarify that “services provided in connection with the audit function” include reviews of the adequacy of the internal accounting control system and reviews of the company’s procedures for “making such determinations” whether or not the service
is provided in connection with the examination of the financial statements.

Note, however, that SAB No. 25 says that services in designing or redesigning the internal control systems and procedures are not considered part of the audit function.

**SAB No. 39, Proscription Against Bookkeeping Services and Preparation of Financial Statements by Auditors**, presents two staff interpretations of accountants' independence rules. The first states that routine bookkeeping services and preparation of financial statements by independent auditors would adversely affect independence irrespective of whether the company for which the service would be performed is located within or outside of the United States and whether or not the involved company is material to the total enterprise. In the second interpretation, the SEC staff takes the position that it is not acceptable to engage the registrant's independent accountant to act as the corporate secretary for a foreign subsidiary.

**OTHER SELECTED SEC RELEASES**

In **Release 33-6190**, the SEC has amended its filing requirements for registration Form S-8, which generally covers employee stock plans.

1. An original filing becomes effective automatically 20 days after filing, and a post-effective amendment becomes effective automatically on filing. The effective date of new filings will no longer be accelerated.

2. A new Rule 475a provides that the filing of any pre-effective amendment to a registration statement on Form S-8 is deemed to have been filed with the consent of the Commission for the purposes of Section 8(a) of the Securities Act. This will prevent the 20-day waiting period from beginning again and will permit issuers to amend their filings to include last minute revisions and updated financial statements.

3. An amendment to Rule 477 permits registrants to withdraw original Form S-8 filings without the prior consent of the SEC, if the withdrawal is filed prior to the effective date.

4. Rule 473 is revised to eliminate automatic delaying amendments. The present practice permitting unsold shares to be deregistered by means of a post-effective amendment is not affected.

To accommodate automatic effectiveness, the provisions of Form S-8 relating to resale prospectuses have been amended. The SEC will monitor on an "audit basis" compliance with disclosure requirements both prior to and after filings become effective.
The new filing procedures are effective March 31, 1980.

In Release 33-6202, Amendment to Registration Form S-8 and Annual Report Form 11-K, the SEC has simplified registration and reporting requirements for certain employee plans. The amendments will allow some present S-8 users to use the disclosure and updating features of Form S-16 and to update their S-8 information by means of '34 Act reports (e.g., Forms 10-K, 10-Q, 11-K, 8-K), eliminating the need for filing post-effective amendments. The amendments are effective June 1, 1980.

In Release 33-6221, Amendments to Guides for Statistical Disclosure by Bank Holding Companies, the SEC has significantly amended Guides 61 and 3, particularly as to information in a prospectus (but not financial statements). A major change is that the reporting period has been reduced from five to three years, although five years' information on loans and loan loss experience is still required. Smaller banks are required to report on just two years for all Guide information.

In Release 33-6239, Tender Offers, the SEC has adopted Rule 14e-3. The rule pertains to trading by persons in securities which may be the subject of a tender offer as well as tipping of material, nonpublic information relating to a contemplated tender offer. Rule 14e-3(a) establishes a "disclose or abstain from trading" rule under the Williams Act. Rule 14e-3(b) provides that certain transactions by multiservice financial institutions under certain circumstances which would otherwise be proscribed will not violate Rule 14e-3(a). Rule 14e-3(c) provides that certain transactions which would otherwise be proscribed will not violate Rule 14e-3(a). These exceptions include: (1) the execution by a broker or another agent on behalf of the offering person; and (2) sales by any person to the offering person. Rule 14e-3(d) is designed to prevent leaks of material, nonpublic information relating to a tender offer.

In Release 33-6241, Confidential Treatment under the Freedom of Information Act, the SEC has issued a rule which permits persons filing information with the Commission to request that the information not be released in response to a Freedom of Information Act request. The old Commission rules required separate consideration, upon receipt, for any document for which confidential treatment was requested. Now such documents will simply be kept out of the public file whenever confidential treatment is requested. The SEC will resolve confidentiality requests only when an FOIA request is made for a particular document.

Release No. 33-6261, Disclosing Management Remuneration – Item 4, Regulation S-K, makes a number of technical changes in the disclosure rules, but no change in the fundamental approach. Instructions for the presentation of the remuneration table and who should be included have
been clarified. Remuneration in the form of stock options and appreciation rights has been removed from the table required by Item 4(a) and is now to be presented in an expanded option table. Any form of management remuneration that has been expensed and is not subject to a future contingency must be reported in Column C of the remuneration table. A separate table has been prescribed to report amounts of defined benefit and actuarial pension plans. Other amendments eliminate the need to detail company loans made to management in the normal course of business and limit disclosures of termination remuneration to those officers named in one or both of the last fiscal years.

In Release 34-17099, Statement of Commission Policy Concerning Section 30A of the Securities Exchange Act of 1934, the SEC has now decided that it will not commence enforcement action under the Foreign Corrupt Practices Act in any case in which a public company has received clearance from the Department of Justice prior to May 31, 1981.

The Justice Department has established review procedures whereby it will tell requesting companies whether or not a proposed transaction in a foreign country would lead to Department enforcement action.

OTHER

The Office of Management and Budget (OMB) issued Circular A-122, Cost Principles for Nonprofit Organizations, which replaces existing principles issued by individual agencies, and is intended to provide a uniform approach to determining costs under any federal grant or contract in which costs are used in pricing, administration and settlement. The Circular covers all nonprofit organizations except hospitals; colleges and universities, which are covered by Circular A-21; and state, local and federally recognized Indian tribal governments, which are covered by Circular A-74-4.

In addition, the Circular excludes from coverage over 30 specific nonprofit organizations which, because of their size and nature of operations, are considered similar to commercial concerns and are subject to cost principles included in either the Defense Acquisition Regulations (DAR) or the Federal Procurement Regulations (FPR), as appropriate.

TOUCHE ROSS ACCOUNTING AND AUDITING PUBLICATIONS

An Implementation Guide to FASB Statement 33 is a comprehensive aid which, through discussion and example, deals with many of the implementation problems that accountants and their clients will be encountering as they begin to apply the Statement. Companies which
have worked with a field test version of the guide report that it is an excellent source of information. And the Financial Executives Institute, after reviewing the guide, has distributed copies to all its members.

**Oil and Gas Accounting**, a booklet prepared by the Firm's Denver office, describes recent developments in industry accounting practices. The booklet contains explanations and checklists for Regulation S-X and S-K disclosures, Reserve Recognition Accounting rules under S-X, auditing the reserve report and interest capitalization by oil and gas producers. Also included is a simplified example of how to develop a supplemental RRA earnings summary.

**Survival Basics in the Recession Economy** is a booklet designed to help small and medium-size companies that are particularly affected by an adverse economic climate. The four sections of the booklet offer practical advice on operational savings using simple analytical techniques, tax savings through use of legitimate tax reduction measures, better cash management through working capital analysis and accounting for the realistic effects of inflation.

**The Touche Ross Analysis of the SEC's Integrated Disclosure System** is a 289-page book published by Commerce Clearing House, Inc. The publication provides an in-depth analysis of ASRs No. 279, 280 and 281 wherein the SEC has adopted major revisions to Form 10-K and Regulation S-X and has issued New Uniform Instructions as to financial statement filings. The book presents overviews of the changes required in annual reports to shareholders and proxy statements, Regulations S-X and S-K, Form 10-K, new Form S-15 and other frequently used registration forms. The text of the new rules is presented in discrete paragraphs, followed by the old SEC rules and a Touche Ross commentary on the changes.

**The Touche Ross Guide to Filing the 1980 10-K**, published by Commerce Clearing House, Inc., contains a complete sample Form 10-K which has no incorporation by reference. The financial statements, footnotes, schedules and exhibits included in the example illustrate compliance with the new Instructions to Form 10-K, Regulation S-X and Regulation S-K. Also included are audit checklists for the new Instructions. The recent changes to Item 4 of S-K, Management Remuneration, are also summarized.
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