

Woman C.P.A.

Volume 28 | Issue 3

Article 7

4-1966

Woman CPA Volume 28, Number 3, April, 1966

American Woman's Society of Certified Public Accountants

American Society of Women Accountants

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Recommended Citation

American Woman's Society of Certified Public Accountants and American Society of Women Accountants (1966) "Woman CPA Volume 28, Number 3, April, 1966," *Woman C.P.A.*: Vol. 28 : Iss. 3 , Article 7.

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April 1966 APR 23 '66

the WOMAN CPA

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OFFICIAL PUBLICATION

AMERICAN WOMAN'S SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS

AMERICAN SOCIETY OF
WOMEN ACCOUNTANTS

THE CPAN

Volume 28 April 1966 Number 3

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Accounting Theory: The Cornerstone of Our Profession

Marjorie June, CPA

All accounting activity is supported by a strong cornerstone of accounting theory. The purpose of this article is to review some current trends related to theory that may be helpful to all accountants.

Bulletins and Opinions

In October, 1964, the Council of the American Institute of Certified Public Accountants met to consider one of the most important matters ever brought before it. The Council heard the report of a special committee which recommended essentially that departures from Opinions of the Accounting Principles Board and from Accounting Research Bulletins issued by the former Committee on Accounting Procedure be disclosed either in footnotes to financial statements or in the accountants' report itself. Disclosure is effective for fiscal years beginning after December 31, 1965.

It may be well to interject here a comment on the composition of the Accounting Research Bulletins and Opinions mentioned in the Committee's report. There are 51 Accounting Research Bulletins, and they were issued from 1934 to 1959 by the AICPA's Committee on Accounting Procedure. The Accounting Principles Board has issued six Opinions since it succeeded the Committee on Accounting Procedure. Both the Accounting Research Bulletins and the Opinions discuss specific areas of accounting theory, give the pros and cons of alternative accounting techniques, and usually state a preference for one method over another.

Another pertinent comment would be that, up to this time, pronouncements on accounting principles issued by the Accounting Principles Board were not binding on AICPA members as long as the members had substantial authoritative support for other practices. Thus, the pronouncements had limited authority.

The recommendation of the Committee concerning departures was unanimously adopted and distributed to members of the Institute via a Special Bulletin. This action moved accounting theory and uniformity of accounting principles forward at least one decade.

Consider once again what this Special Bulletin says: Disclosure must be given, either in footnotes to financial statements or in the accountants' report, of departures from Opinions of the Accounting Principles Board and from Accounting Research Bulletins. It does not say that accounting *must* be done in the Institute's

way, only that if there is a deviation, the public must be informed of it and its effect on income. Of course, if the deviation is too original and does not have substantial support in practice, the CPA's report will probably contain an exception. A discussion of that problem is beyond the subject at hand.

The action by Council in issuing this Special Bulletin has an effect on each one of us—whether we work in private industry or are in public practice. First to be determined is what the Opinions and Accounting Research Bulletins say; next, whether any of our accounting practices, or those of our clients, are in violation of the Opinions and Accounting Research Bulletins; and then, if they are, what we are going to do about them.

After the Opinions and Accounting Research Bulletins are read, one thought will surely come to mind. Many of them cite several acceptable methods for doing things. For instance, the Bulletin on inventories permits use of *lifo*, *fifo* or average cost. Pensions may follow the cash or accrual basis.

It is the thought of the APB, however, that as studies in depth are completed, opinions will be issued which favor only one acceptable accounting practice in any given fact situation. This then will tend to promote the comparability of financial statements. One can readily see that the effect of the Special Bulletin will have an even greater influence in the future.

The Accounting Principles Board or APB, as it is most generally called, was established in 1959 with the following objective:

“ . . . to advance the written expression of what constitutes generally accepted accounting principles, for the guidance of its (the Institute's) members and of others. This means something more than a survey of existing practice. It means a continuing effort to determine appropriate practice and to narrow the areas of difference and inconsistency in practice.”¹

The majority of the Board's 21 members are prominent accountants in public practice whose knowledge of the practical aspects of accounting and reporting are unquestioned, while the minority are equally qualified members from industry, government, and the universities.

Since the APB generally holds three or four two-day meetings each year, the research and preparation of background material must be

done by the Accounting Research Division of the AICPA.

This Division is composed of a Director of Research and several Research Associates who work on various projects assigned by the APB. The Division has recently added an Administrative Director in order to speed up the production of "work in process." Also, the Division from time to time makes use of outside consultants.

The relationship between the APB and the Accounting Research Staff is well-described by Reed Storey, Director of Accounting Research, in his book, *The Search for Accounting Principles*.² The procedure would approximate the following:

1. A problem exists, and the Accounting Research Division is instructed to prepare a study.
2. The author of the study is counseled by a project advisory committee.
3. The Study is published, and comments are encouraged.
4. The APB considers the Study recommendations, and either adopts them through the issuance of an Opinion, or adopts its own Opinion contrary to the recommendations of the Study. In two instances, the APB Opinions adopted were contrary to the Study recommendations.

It might be well to point out that not all Opinions emanate from Studies. Opinions 1, 2, 4 and 6 are in this category. Opinion 6, *Status of Accounting Research Bulletins (Journal of Accountancy*, November 1965, p. 54) is the outgrowth of the Council's instructions last October to review prior to December 31, 1965, all Bulletins ". . . and determine whether any of them should be revised or withdrawn."

Formulation of Theory

As must be apparent, the formulation of accounting theory, as contained in the Institute's Opinions, is rather well-structured. There is one way, however, in which we can have a part, and that is by reading the Studies, discussing them with others, and notifying the APB of our feelings. This awesome group cannot make decisions in a vacuum, and we can help to fill some of the "empty spaces."

Recent Studies

To give an idea of what some of the Accounting Research Studies (ARS) are like, the following is a brief review of numbers 6, 7, and 8, the most current ones published, none of which has resulted in opinions as yet by the APB.

ARS 6, *Reporting the Financial Effects of Price-Level Changes*, was written by the Staff

of the Accounting Research Division, and published in October, 1963. In 1961, the APB had passed a resolution which said ". . . the assumption in accounting that fluctuations in the value of the dollar may be ignored is unrealistic, and that . . . the Director of Accounting Research . . . set up a research project to study the problem . . ." This Study is the result of that direction. Considerable attention by accountants was focused on the price-level problem in the early fifties because of the very rapid inflation in our country following the Second World War. The American Accounting Association in 1951 recommended that price-level adjusted statements be used to supplement primary statements, and several such reports were prepared as an outgrowth of their study.

The only statement by the AICPA during this period which touched on the area of price-level adjustments was a reaffirmation of its position that depreciation be based solely on historic cost.

ARS 6 carefully defines what is meant by price-level changes and, just as importantly, what is excluded from the term. Price-level changes, as used in this study, do not include replacement costs or changes in the relative market position of the individual item. Price-level changes do mean, however, changes in the general purchasing power of the dollar that occur during a period of inflation or deflation.

The Study recommends that supplemental information recognizing price-level changes be included in reports to management, stockholders, etc. It does not recommend that price-level adjusted statements replace those based on historic costs.

Supplemental information may be given in several ways:

1. Parallel columns showing price-level adjusted information, along with the financial statements themselves.
2. A second set of financial statements using completely or partially adjusted data may be included, along with those based on historic costs.
3. Commentary, complete with charts and graphs, may give the impact of price-level changes without disturbing the conventional financials.

Needless to say, each of these presentations has advantages and disadvantages in any given set of circumstances.

There are several valuable appendices to the Study itself. The first, by Cecilia Tierney, deals with the Index Number problem, a problem that has stumped accountants in years past. The next is a demonstration of the adjustment technique which could be followed as

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The Public Image

Mary F. Hall, CPA

"Oh, I do so admire anyone who is good with figures. I can't even balance my own check book," or "I don't see how anyone can have the patience to work with all of those figures. It would drive me crazy." Familiar refrains, aren't they?

Obviously, the general public has no concept of the dynamic, professional nature of the accountant's services and has not even a glimmer of understanding of the vital contribution that our services make to the common good of society.

Lacking the glamour of a Dr. Ben Casey or a Perry Mason who emphasize in dramatic detail the benefits that the medical and legal professions contribute to the well-being of their fellow-man, we have no direct thrust into the day-to-day living of working men and women who have little or no reason to have first hand knowledge of our work. As a consequence, the value of our services as a benefit to society and as a necessity to the furtherance of the good life is remote, vague and questionable in the minds of the general public.

Regrettably also, this lack of knowledge and understanding appears to extend into our schools where we too often hear not only accountancy but the entire business community down-graded as a source of service to humanity. Therefore, we, in our profession, must consider ways to portray to the public the valuable role that accounting plays in the free enterprise segments of the world.

One of the first musts in selling anything is for the salesman to be sold on the product or service he or she is merchandising. Arises the question—Are you really sold on yourself as a professional? Do you consider your professional status contemporary to that of an attorney, a doctor, a teacher, an engineer, an architect? Or do you in your secret mind have a nebulous, negative, pessimistic opinion of the real value of accounting as an important factor in the powerful decision-making function wielded by the leadership system?

Let us look at accountancy for a moment through the eyes of a senior investment officer of the International Finance Corporation, an affiliate of the World Bank. In the August issue of the Journal of Accountancy, the gentleman said, "Whether for an individual organization or for a nation, accounting is the coherent assembly of economic data so as to understand the past and plan for the future." He also said, "The impact which accountancy has and the role it could play in over-all economic development is more extensive and influential than is generally recognized."

We in the accounting profession hold in our hands the talents necessary for that "coherent assembly of economic data so as to understand the past and plan for the future." Consider this one fact: Over 75% of all business failures in this country are directly attributed to a lack of adequate financial information in the hands of management. Do we fully grasp the significance of our professional role in the scheme of things?

Maybe we could do with a Dr. Ben Casey or a Perry Mason to tell our story via the television screen. Or maybe a Dick Tracy sequence will some day give sympathetic portrayal of at least a few of the many values that the general public derive from our services.

Meanwhile, back at the ranch, we everyday actors and actresses have the opportunity to play the most dramatic, effective roles of all—the real live professionals contributing our know-how to the business complex that is, after all, the basis of our country's ability to progress for the good of all of our citizens.

We must feel, look and perform like professionals. We must have time to be active in our communities, civic, social, religious, charitable and political groups. We must accept bids to represent our firms on United Appeal Committees, to serve on committees for the Chamber of Commerce. To duck out with a plea of "no time" is to shirk the opportunity to sell a proper professional image to the public. **LET US BE WORKERS, NOT SHIRKERS!**

Accounting Theory: The Cornerstone of Our Profession

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a guide to developing price-level adjusted statements. Also included is a section containing examples of price-level adjustments appearing in published financial statements.

The Study will be a good starting point for anyone interested in understanding the price-level problem, but it is a subject which requires complete concentration on the reader's part.

The Accounting Principles Board is continuing its consideration of the Study, but acceptance of price-level adjustments will depend to a great extent on future changes in the value of the dollar.

ARS 7 is *Inventory of Generally Accepted Accounting Principles for Business Enterprises* by Paul Grady. This was published in March, 1965, and is just what the name implies—an inventory comprised of AICPA pronouncements and selected SEC Accounting Series Releases. Continuity is given to the many quotations by using frequent excerpts from *Montgomery's Auditing*.

The Study defines accounting in a manner that includes a broader range of activities than had previously been considered part of the accounting definition.

“Accounting is the body of knowledge and functions concerned with systematic originating, authenticating, recording, classifying, processing, summarizing, analyzing, interpreting, and supplying of dependable and significant information covering transactions and events which are, in part at least, of a financial character, required for the management and operation of an entity and for the reports that have to be submitted thereof to meet fiduciary and other responsibilities.”⁴

A word-by-word comparison would be impractical here, but there are significant ramifications to a definition this broad. We, as accountants, indirectly take on greater responsibility as the “accounting” definition itself is extended.

As you know, AICPA material and SEC Accounting Series Releases have always been catalogued in a sequential manner according to issue date. The material in ARS 7, however, is grouped by general topic. For instance, chapters are devoted to income and expense, equity, assets, liabilities, financial statements, etc. For this reason, the Study should be particularly helpful to the student of accounting, as well as to anyone in practice who is concerned with one particular aspect of accounting theory.

A committee of the APB is considering some of the chapters of the Study with a view to issuing brochures on the objectives of financial statements and the concepts underlying financial accounting. These brochures may help to create better understanding by nonaccountants of what financial statements are intended to be and do.

Accounting Research Study 8, *Accounting for the Cost of Pension Plans*, released in May, 1965, was written by Ernest L. Hicks, a partner of Arthur Young & Co. It is not only the most recent study published, but also that which has the most practical application for most accountants.

Before an analysis of the Study, consideration should be given to the two terms used whenever pensions are discussed. They are current or normal costs, and past service costs.

Normal costs are those costs which result from work this year, when the plan is in effect. There will be normal costs next year, based on next year's work, and so on, into the future.

Past service costs are those costs based on work done by employees in years prior to the adoption of the plan. Both normal and past service costs are usually determined by actuaries.

Mr. Hicks began ARS 8 by reviewing current accounting practices for pension costs; he found they took several forms:

1. The recognition as expense of only the current service costs, and ignoring past service costs.
2. The recognition as expense of the current service costs and interest on the unfunded past service costs.
3. The recognition as expense of the current service costs, and a portion of the past service costs.

With all of these practices considered to be “generally accepted,” is it no wonder that a Study was needed?

The Study states that proper accounting for pension cost hinges on the timing of charges to expense. What the proper timing is, of course, depends upon the type of pension plan under consideration.

According to the Study, pay-as-you-go plans, with the expense recorded only when the payment is made to the pensioner, approximate the cash basis of accounting and are unacceptable for accrual systems.

The terminal funding method, with the expense recorded only when a lump-sum annuity is purchased, also approximates the cash basis, and therefore, according to Mr. Hicks, is also unacceptable for accrual systems.

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Preliminary Digest of Medicare and Supplementary Medical Insurance Basic Features

Mary L. Hemmy and Mary Ellen Warren

(Key to abbreviations in article, page 10)

MEDICARE

(Basic Hospital Insurance)

1. ELIGIBILITY

- (A) anyone 65 years or older, and
- (B) born before 1903 if he has never paid any SS tax
- or*
- (C) drawing SS benefits or RR retirement benefits
- or*
- (D) eligible to draw SS benefits but not doing so (e.g., still working), and
- (E) not enrolled in the Federal Government health plan
- (F) not an alien not admitted for permanent residence
- (G) not an alien who has not lived in U.S. for 5 years just preceding filing for benefits
- (H) not a subversive or person convicted of sabotage, espionage or treason.

IN EFFECT—any person who is 65 years or older is eligible, except for (E), (F), (G) and (H) above.

2. HOW TO APPLY

- (A) those already receiving SS or RR retirement benefits will automatically get a card from SSA July 1, 1966 signifying eligibility.
- (B) those eligible now for SS or RR retirement benefits, but not now receiving them, file application at local SSA office (probably need SS card, W-2 for previous year, and proof of age)
- (C) those not now covered by SS or RR retirement benefits and otherwise eligible register for Medicare when SSA offices start "enrolling" people for supplemental insurance. First "enrollment" for those who will be 65 before January 1, 1966 began on September 1, 1965 and ends on March 31, 1966.

SUPPLEMENTARY MEDICAL INSURANCE

1. ELIGIBILITY

- (A) anyone 65 or older who is eligible for basic Medicare benefits
- or*
- (B) anyone 65 or older who is enrolled in the Federal Government health plan
- or*
- (C) anyone 65 or older who is receiving RR retirement or Civil Service retirement benefits.

IN EFFECT—all who are 65 or older except (F), (G) and (H) under Medicare eligibility.

2. HOW TO APPLY

- (A) those already receiving SS or RR retirement benefits, those receiving Civil Service retirement benefits, and eligible persons on welfare rolls will receive an application form from SSA.

MEDICARE

SUPPLEMENTARY MEDICAL INSURANCE

3. CERTIFICATION OF ELIGIBILITY

A health card issued by Social Security Administration prior to July 1, 1966 (for first beneficiaries), indicating eligibility for *basic* Medicare benefits.

4. TIME TABLE FOR BEGINNING OF FIRST BENEFITS

- (A) Hospital care July 1, 1966
- (B) Home health benefits July 1, 1966
- (C) Hospital outpatient diagnostic tests July 1, 1966
- (D) Nursing home care January 1, 1967

5. BENEFITS AND DEDUCTIBLES

(A) *Hospital Care*

Up to 90 days care for each spell of illness.

Patient pays—1st \$40 and \$10 per day beyond the 60th day to 90th day; after 90th day patient pays entire cost.

SSA pays—daily cost beyond 1st \$40 for the first 60 days and difference between \$10 and daily cost after 60th day to 90th day. "Spell of illness" ends when patient is outside hospital or nursing home for 60 consecutive days.

Hospital care includes—semiprivate room (2-4 beds), staff nursing, social service, use of regular hospital equipment, prescribed drugs, services of house officers. Lifetime limitation of 190 days in a mental hospital. Payment will be made only to hospitals with an appropriate agreement with the Federal Government.

(B) *Home Health Benefits*

- (1) Available only after the person is hospitalized at least 3 days and
- (2) Available only when doctor establishes a plan for home health services within 14 days after discharge from hospital (or nursing home) and plan includes "skilled" nursing care on intermittent basis *or* physical therapy or speech therapy for condition for which person was being treated in hospital or nursing home.

3. CERTIFICATION OF ELIGIBILITY

A health card issued by SSA prior to July 1, 1966 (for first beneficiaries), indicating eligibility for *basic* Medicare benefits *and* supplemental insurance.

4. TIME TABLE FOR BEGINNING OF FIRST BENEFITS

- (A) Physician services July 1, 1966
- (B) Certain dental services July 1, 1966
- (C) Home health benefits July 1, 1966
- (D) Non-hospital psychiatric care July 1, 1966
- (E) Other medical services July 1, 1966

5. BENEFITS AND DEDUCTIBLES

(A) *Physician Services*

House and office calls and physician's services rendered in a hospital, nursing home or other institution (not routine physicals, immunizations, examinations for glasses or hearing aids, cosmetic plastic surgery). Includes physicians, surgeons, and various specialists.

(B) *Dental Care*

Only for jaw or other facial-bone surgery (not ordinary dental care).

(C) *Home Health Visits*

Provides same 100 visits as provided under *basic* Medicare and under same conditions, but *without* need for prior hospitalization.

or

provides 100 visits in addition to those provided under Medicare (but requiring hospitalization as part of Medicare).

(D) *Psychiatric Care*

Treatment outside a hospital—SSA will pay one-half the bill up to \$250 a year.

(E) *Other Medical Services*

- (1) X-ray and laboratory tests in an approved laboratory, or in one operated by a hospital or doctor.
- (2) Radiation therapy of all kinds.

MEDICARE

5. BENEFITS AND DEDUCTIBLES

(B) *Home Health Benefits continued*

- (3) Includes 100 visits for
 - (a) Part-time or intermittent nursing care by, or under supervision of, R.N. (not private duty R.N.)
 - (b) Physical therapy, occupational therapy and speech therapy
 - (c) Medical social work services
 - (d) Part-time or intermittent services of home health aide
and
 - (e) Medical supplies other than drugs, such as dressings and splints
 - (f) Use of medical appliances (e.g., wheelchairs and crutches).
- (4) *Duration*—benefits end one year after patient's discharge from hospital or nursing home (unless rehospitalized after 60 days—when he is eligible on discharge for 100 visits for the new spell of illness).
- (5) *Home health services* must be supplied by or through a home health agency.

(C) *X-ray and Other Diagnostic Tests* provided by a hospital on a non-overnight basis.

Patient pays—1st \$20 for services in any 20-day period plus $\frac{1}{2}$ of the balance.
SSA pays—the difference between the above and the total bill.

(D) *Nursing Home Care*

Up to 100 days of care for each spell of illness.

SSA pays—1st 20 days and the difference between daily charge and \$5 per day from 21st day to 100th day.

Patient pays—\$5 per day from 21st to 100th day.

Qualifying Conditions:

- (1) Patient must spend at least 3 days in hospital and enter the nursing home within 14 days after discharge.
- (2) Skilled nursing care must be required for same condition treated in hospital.
- (3) Physician must certify the above and certify need for continued care at specified intervals.
- (4) The facility (nursing home) must be primarily engaged in providing skilled nursing care and related services or rehabilitation services and must meet various other provisions.

SUPPLEMENTARY MEDICAL INSURANCE

5. BENEFITS AND DEDUCTIBLES

(E) *Other Medical Services continued*

- (3) Surgical dressings, splints, casts and other "devices" to repair fractures and dislocations.
- (4) Rental of such equipment as hospital beds, wheelchairs, and oxygen tents.
- (5) Ambulance service to nearest hospital, if needed.
- (6) Artificial limbs, eyes, braces (not orthopedic shoes).
- (7) Other prostheses (but not dentures, glasses or hearing aids).

Patient Pays—1st \$50 of any of the above received in one year and $\frac{1}{2}$ of the reasonable cost of the balance.
SSA Pays—the difference.

MEDICARE

5. BENEFITS AND DEDUCTIBLES

(D) *Nursing Home Care continued*

Nursing Home Care includes:

- (1) Bed and board in a semiprivate room limited to four patients.
- (2) Nursing care (not private R.N.)
- (3) Physical therapy, occupational therapy and speech therapy
- (4) Medical social services
- (5) Drugs and appliances usually furnished
- (6) Services of house officers attached to a hospital having working agreement with the nursing home.

6. THE ESSENTIAL INGREDIENT (IN ADDITION TO AGE) PHYSICIAN COOPERATION TO:

- (A) Certify need for hospital care and re-certify at intervals during a prolonged stay.
- (B) Certify need for home health services, supervise patient's care, and re-certify need for these services at intervals.
- (C) Certify need for nursing home care, subject his judgment as to need for continued care to scrutiny of a utilization review committee of his colleagues, and supervise patient's care.

SUPPLEMENTARY MEDICAL INSURANCE

6. THE ESSENTIAL INGREDIENT (IN ADDITION TO AGE AND PAYMENT OF PREMIUM) PHYSICIAN PARTICIPATION:

- (A) Cooperation as outlined under *Medicare*
plus
- (B) Willingness to accept payment under the SSA Insurance Program (and all the desk and paper work which will necessarily be required).

7. INSURANCE PREMIUM AND HOW PAID

For the 1st 2 years—\$6 per month to be met as follows:

- \$3 by Federal Government
- \$3 by individual

States may pay the \$3 for those receiving public assistance.

Deductions can be made for individuals in their checks for SS, RR, or Civil Service retirement benefits.

Others will make direct payments to SSA.

KEY TO ABBREVIATIONS IN ARTICLE

SS—social security

RR—railroad

SSA—Social Security Administration

RN—registered nurse

TAX FORUM

DORIS L. BOSWORTH, CPA

Significant Changes in the Moving Expense Area

With the development of business on a nationwide basis, many problems have arisen, not only from the administrative, but also from the tax point of view. One of these problems has been the tax treatment of reimbursement by an employer of expenses incurred by an employee in moving his family to a new location. Unfortunately, the tax consequences devolve primarily upon the employee. Any portion of the reimbursement that is income to the employee from the Treasury Department's point of view merely results in a reclassification of the expense as compensation as far as the employer is concerned. There is, of course, the question of failure to withhold, but the Service does not ordinarily pursue this. Rather it is the employee who finds himself faced with paying additional taxes on an item arising out of benefits to be derived by his employer.

Recognition of the psychological, as well as financial, aspects of shifting a family from one location to another has engendered rather liberal interpretations on the part of employers as to what constitutes reimbursable moving expenses. Not only do they pick up the tab for the usual costs incurred in moving an individual, his family and household goods, but expenses for preliminary visits to the new location during the period of search for a permanent home may also be paid. In a great many instances, allowances are also given for draperies and carpeting, a not inconsiderable cost in moving from one house to another. In 1965, a Circuit Court case and a Revenue Ruling focused attention on the fact that such allowances will not come within the purview of the Treasury Department's interpretation of what constitutes non-taxable reimbursed moving expenses. As a consequence, many corporations are now having to evaluate the tax impact of former policies, and to look for acceptable solutions to the problem.

In *England vs. United States*, 345 F(2d) 414, CA-7 (1965), the taxpayer was transferred by his employer from Missouri to Illinois. During the period while the employee was looking for a new residence, the company reimbursed him for expenses incurred in connection with temporary living quarters. The Seventh Circuit took the position that such reimbursement of personal living expenses constituted taxable

income to the employee. This position was reiterated in Revenue Ruling 65-158 where items of gross income subject to withholding are spelled out. Included therein are living expenses of a temporary nature while looking for a home, drapery and rug allowances, and other specifically enumerated items that are usually incurred in connection with changing one's residence. Although the *England* case is being appealed to the Supreme Court, the criteria established there and in the Revenue Ruling will prevail in the intervening period.

Faced with the problem of transferring employees to new locations of employment and the resulting tax-wise disadvantages, company officials are presently considering the necessity of urging Congress and the Treasury Department to enact laws that will alleviate the situation. The immediate steps that have been taken, however, are to reexamine preliminary trips to analyze their true nature or, in the alternative, where such trips do not conform to the Regulations, to increase compensation or reimbursement to cover the tax cost to the employee.

Under the first alternative, employers recognize that often the employee who has been selected for transfer is sent out on a trial basis to the new location. Several questions have to be resolved at that time: is he capable of handling the problems to be encountered in the new territory; will there be personality conflicts with the employees already at that location; and will he be the best choice for the new position. The trial period is not, therefore, properly characterized as moving expense; rather it is business travel and should find its way into that account.

Of course, it is only natural that the employee will be looking for a new residence, during his free time, in the event that the transfer is ultimately consummated, but this should not change the aspect of the trip. The danger always exists that where an extended stay in another city is followed by acceptance of a position in that city, the Treasury Department will attempt to impute actual transfer at the outset of the trip. This contention should be overcome in instances where there has been documentation in the form of correspondence between the company and the employee as well as internal memorandums concerning the nature of the trip.

Accounting Theory: The Cornerstone of Our Profession

(continued from page 6)

The last type of plan, the defined benefit plan, is one which is usually funded through periodic payments to a trustee, and the company's expense is recorded annually, based on an actuarial cost method. There are several actuarial cost methods which may be used that properly reflect the expense on an accrual basis.

The problems connected with defined benefit plans are usually centered on the amount of past service costs that exist when a plan is adopted. Depending on the ages of the employees and their lengths of service with the company, the amount of past service costs for a relatively small company can easily exceed a million dollars.

Current reporting practice of pension matters is to incorporate in the financial statements or their notes, the amount of pension costs in expense, the amount of unfunded prior service cost, the basis for funding such cost, and a brief explanation of any changes to the plan.

Mr. Hicks suggests that if the recommendations of the Study are adopted, the range of accounting practices will be limited, and therefore disclosure may be diminished. Significant changes to plan, however, which have an effect on pension expense, will continue to be disclosed.

Adoption of the Study's recommendations will create problems of implementation in the year of transition. It is suggested by the Study that a determination be made of the cumulative differences between previous accounting methods and the recommended ones and that the cumulative effect between methods, net of tax, be charged preferably to prior periods or to future ones.

ARS 8 also contains helpful information in the Appendices. One deals with the socio-economic aspects of pensions, while another deals with actuarial techniques. The actuarial material serves as a sound introduction for an accountant who is uninformed in this area. Pensions are an important part of our business economy today, and it is imperative that each of us be aware of the information in this Study. Incidentally, it is written in quite a readable manner.

Studies in Preparation

Presently in preparation are studies dealing with the following topics: Income Taxes in Corporate Financial Statements, Foreign Operations, Intercorporate Investments, Goodwill and Business Combinations, Product Research and Development Expenditures, Extractive In-

dustries, Materiality, and Income and Retained Earnings. The Accounting Research Division obviously has a rather ambitious program under way.

It is important to emphasize that Accounting Research Studies 6, 7, and 8 have not been approved, disapproved, or otherwise acted on by the Board, the membership, or the governing body of the Institute. They are published to stimulate thought and discussion on important areas of accounting.

Conclusion

To this point the center of discussion here has been the Institute's Special Bulletin requiring disclosure of departures from APB Opinions, the organization and structure of the APB and the Accounting Research Division, and three of its latest studies. The reader may ask why we should be concerned about these activities, but it isn't necessary to say that it has been rather fashionable in the past few years or so, to take pot-shots at accounting, accounting theory, and accounting principles. Some of the criticism has been justified, and some has not. At any rate, the AICPA through its APB and its Research Division has worked diligently to clear up the faults it found.

The efforts just described here are only a small part of the effort that has been expended. But the responsibility is not theirs alone. We, individually and as an organization, can no longer stand back and be observers. The written expression of accounting principles which is being developed affects us, no matter what our area of responsibility. Accounting theory serves as a cornerstone on which our profession is based. We must take an interest in its development, have knowledge of its perimeters, and most certainly contribute to its development.

References:

¹Reed K. Storey, *The Search for Accounting Principles* (New York: American Institute of Certified Public Accountants, 1964), p. 55, citing *Organization and Operation of the Accounting Research Program and Related Activities* (New York: American Institute of Certified Public Accountants, 1959), p. 9.

²Storey, p. 65.

³AICPA, *Reporting the Effects of Price-Level Changes* (New York: American Institute of Certified Public Accountants, Accounting Research Division, 1963), p. 1.

⁴Paul Grady, *Inventory of Generally Accepted Accounting Principles for Business Enterprises* (New York: American Institute of Certified Public Accountants, 1965), p. 4.

TIPS FOR BUSY READERS

MARY F. HALL, CPA

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"Accounting for Human Assets," Roger H. Her-
manson, *Occasional Paper No. 14, Bureau
of Business and Economic Research of the
Graduate School of Business Administration,
Michigan State University.*

The theme of this monograph is that balance sheets should include what the author calls "Operational Assets" as well as owned assets. Operational assets are defined to consist of all scarce resources operating in the business that are not owned. The view is expressed that the operational asset most frequently excluded from financial statements is the human resource. The expected benefits from including operational assets are said to be increased comparability and completeness of financial statements, leading to a more efficient allocation of funds in the economy, a rejuvenation of the position statements, a closer tie-in between financial statements, and an aid to the analysis of firms for internal purposes. The monograph has been written from the point of view of the absentee investor.

The author discusses two methods which could be used for valuing operational assets. The first he calls the Unpurchased Goodwill Method and the second is referred to as the Adjusted Present Value Method. In the unpurchased goodwill method a rate of net income on average owned assets in the economy is determined. In each firm the amount by which actual net income exceeds the normal income is capitalized at the predetermined rate as operational assets. The author recommends journal entries debiting operational assets and crediting an equity increase for those companies having actual income above normal. For companies having less than normal income the entry would be a debit to an equity decrease account and a credit to operational negative assets.

The adjusted present value method uses a weighted average of the last five years' performances and then uses the weighted average to modify the present value of the expected wage payments over the next five years.

The remainder of the monograph discusses the presentation of data in the balance sheets and the benefits from the proposal and the economic implications of it. The idea is stressed that accountants should report economic income rather than the presently reported accounting income. Reporting economic income would involve reporting unrealized changes in the value of both tangible and intangible assets. Market values would be used instead of historical costs.

The author admits that the monograph suggests a fairly substantial change in accounting practice and that the ideas expressed are too impractical to be applied at this time. In order to prepare statements in accordance with the suggestions made here, it would be necessary for a company to have a figure, representing the average income of all companies which it can use for purposes of comparison. Such information for previous years is now available, for example, in the Dun and Bradstreet ratios, and a computer system such as the author suggests could make the information even more current.

The ideas presented in the monograph are somewhat unusual, but the only way that progress can be made is for new ideas to be presented and tried out. Only time can tell whether the ideas contained here will be adopted in the future.

M.E.B.

"Data Systems That Cross Company Boundaries," Felix Kaufman, *Harvard Business Review*, January-February 1966, Volume 44, Number 1.

The arrival of the second decade of the computer without a significant number of successful intracompany total system integrations may be due to a fault in the total systems concept, according to Mr. Felix Kaufman. The author sees each company system as only a part of a larger total system and proposes that company boundaries may not be the most significant system boundaries. He sees computer communication and computer time-sharing as the keys to the development of broader intercompany information systems and notes that such an innovation would have a great influence on the way in which business is conducted.

The author envisions the adoption of a central, time-sharing system by several airlines, in order to provide a more efficient service for interline reservations. He believes that retailers and manufacturers would benefit from a direct, real time computer communication of retail sales information from the sales floor to the manufacturer's plant, assuring the timely production and shipment of replenishment stocks. He submits that small business will be forced to adopt intercompany computer communication under a time-sharing plan, in order to compete with vertically integrated companies which have developed sophisticated information systems. The ultimate refinement of intercompany systems would include a paperless clearing house for the processing of account claims and accepted claims without the movement of documents. The use of checks would be largely eliminated by the use of machine language recordings in the central system. Legal evidence of transactions could be provided by a simultaneous recording on a nonerasable medium, such as film.

The author views the development of the broader system as an important step in the elimination of redundancy in the recording of transactions. He suggests also that the recognition of the advantages of larger data processing systems will initiate a trend toward the creation of larger legal entities, resulting in additional motivation for mergers.

V.R.H.

"Accounting vs. Federal Regulation—Is There an Emerging Discipline?" A. T. Samuelson, CPA, *National Association of Accountants Management Accounting*, October 1965, Volume XLVII, Number 2.

This article discusses the impact on accounting principles of the various Federal regulatory authorities. The article also proposes the need for greater uniformity in accounting and agreement on accounting principles. It raises the question as to whether the accounting profession can conduct the theoretical research for development of accounting principles that should be followed, and then abide by its determinations. Mr. Samuelson asks whether the Federal regulatory agencies may not in the future be more influential than they are at present in determining acceptable accounting practices.

The article points out that some actions by regulatory agencies with respect to accounting have a rather limited or transitory

effect, but many actions have a long-run effect on principles and are profoundly shaping the development of current accounting practices. Among other activities, the Federal regulatory agencies have the authority to prescribe accounting systems, reporting forms, and related regulations for use by the companies under their jurisdiction. In addition, the Securities and Exchange Commission has the authority to take over the prescribing of accounting principles for general acceptance, but so far the Commission has felt that such a development would not be desirable.

In discussing the pursuit of "generally accepted accounting principles," the author points out that during the last century the American economy has experienced a transformation at a rapidly accelerating pace. Because of this transformation, there is no alternative to some governmental participation in influencing the direction of accepted standards of conduct and in bringing into line the deviators from such conduct. Mr. Samuelson believes that the accounting profession has seemed slow to recognize the impact of governmental participation and to provide a climate for narrowing the differences on accounting principles.

The application of the principles enunciated by the American Institute of Certified Public Accountants has rested upon their general acceptability, rather than upon requirements as to courses of action by the members of the Institute. Educators occupy a position of independence and can conduct theoretical research suitable for use in determining and promoting acceptable accounting practices, but they possess no effective means of insisting that their findings be followed by the accounting profession and the regulatory agencies.

Mr. Samuelson concludes that accounting reforms can be achieved only under an authoritative leadership which is capable of enforcing its conclusions as to what should be generally accepted accounting principles. He also feels that the practicing accountants appear to be unwilling, and the educators to be unable, to enforce a solution that permits alternatives only when alternatives are justified by special circumstances. He leaves the reader to decide, considering the vigor and potency of regulatory agencies on the ascendancy, how an accounting discipline may emerge in the years ahead.

This is a well-written and thought-provoking article and the subject is one which concerns not only all accountants, but the entire business community as well.

M.E.B.

EDITOR'S PAGE

The first article in this issue is the manuscript of a talk given at the AWSCPA-ASWA 1965 joint annual meeting. The author, Miss Marjorie June, CPA, is a member of the national accounting and auditing staff of Touche, Ross, Bailey & Smart and is also a lecturer at De Paul University, Evening Commerce Division. She holds degrees from Miami University and the University of Indiana and has been honored by memberships in Phi Beta Kappa, Beta Gamma Sigma and Beta Alpha Psi. She is currently serving as Recording Secretary of the Chicago Chapter of ASWA and as a Director and Chairman of the Research Committee of AWSCPA.

"The Public Image" is reprinted from the November 1965 issue of *The Queen City Spokesman*, bulletin of the Cincinnati Chapter of ASWA. The author, Miss Mary F. Hall, CPA, is Associate Editor of *The Woman CPA*

and was introduced in our December 1965 issue.

"Preliminary Digest of Medicare and Supplementary Medical Insurance Basic Features" was prepared by Miss Mary L. Hemmy and Mrs. Mary Ellen Warren. Both are associated with The Benjamin Rose Institute, Cleveland, Ohio—Miss Hemmy as Executive Director and Mrs. Warren as Comptroller. Mrs. Warren is a member of the Cleveland Chapter of ASWA.

"Tips for Busy Readers" this month contains reviews of articles which are particularly thought-provoking. Two of the reviews advance intriguing, new ideas, and the other review asks a very important question.

The Education Committee of AWSCPA has recently published a "Treasurer's Handbook" for the guidance of treasurers of clubs and organizations. Copies are available at National Headquarters for a nominal charge.

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