

University of Mississippi

eGrove

Guides, Handbooks and Manuals

American Institute of Certified Public
Accountants (AICPA) Historical Collection

1969

Raising Accounting Standards

Leonard M. Savoie

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_guides



Part of the [Accounting Commons](#)

Recommended Citation

Savoie, Leonard M., "Raising Accounting Standards" (1969). *Guides, Handbooks and Manuals*. 1315.
https://egrove.olemiss.edu/aicpa_guides/1315

This Book is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Guides, Handbooks and Manuals by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

RAISING ACCOUNTING STANDARDS

by

Leonard M. Savoie

before

The Conference on Empirical Research
University of Chicago

May 15, 1969
Chicago, Illinois

RAISING ACCOUNTING STANDARDS

The American Institute of Certified Public Accountants is dedicated to raising accounting standards. Although the rate of progress in raising standards is sometimes slower than we would hope, progress is being made, and there are indications that the rate of progress will be increasing.

Recent Progress. The Institute's Accounting Principles Board has just added a third Opinion to its output for this year. The first Opinion dealt with reporting net income of commercial banks, the second with accounting for convertible debt and debt issued with stock purchase warrants, and the third with computing earnings per share.

Although there were some delays in getting each of these opinions out, as compared to original time schedules, the fact that they were finalized is cause for satisfaction, because each of the opinions faced strong opposition from various groups. This is not new or surprising, for every subject tackled by the Board is controversial and strong opposition may be expected from some quarter for any position taken.

While some financiers and business conglomerators complain about what the Board is doing, many observers are commenting favorably about its work.

One syndicated columnist recently wrote an article about the APB entitled, "They Act as Management's Conscience". In it he said:

"Accountants are getting bolder. . . They've brought the controversial 'earnings per share' into the back-of-the-book figures covered by the opinion. They are trying to draft rules to cope with the problems raised by conglomerates and other new developments, and to win acceptance of those rules.

"It's remarkable that in this era of big government, so much of this regulation has been left up to the accountants."

I agree with this observation. It is remarkable that the accounting profession is so heavily involved in self-regulation of private enterprise. Government does have a major impact on this regulatory process, but nevertheless the basic function is carried out by the profession -- by the American Institute in setting standards and by its practicing members in implementing these standards.

For those of us who believe in the private enterprise system, this is a most appealing arrangement. To continue to enjoy the privilege of self-regulation through professional standards calls for timely responsiveness to public needs. Today the public is demanding higher accounting standards and we are determined to provide them.

Encouragement for the Future. Encouraging signs for the future are noted on a wide front. One is the very fact that the public is demanding more and better financial information. This has led to the willingness of other organizations in the financial community to commit substantial resources to aid in the process of delineating accounting principles. A demanding time schedule has been established for the Accounting Principles Board by its planning committee. Also, the organization and staffing of the Institute has been improved. And research efforts in general have been increased, as evidenced in this meeting in which we are taking part.

Cooperation by Other Organizations. The high interest in improving financial information is reflected in the efforts committed by other organizations in the financial community. The American Institute and the American Accounting Association have long engaged in various cooperative efforts. This pattern has now been extended to groups such as the Financial Executives Institute, Financial Analysts Federation, Robert Morris Associates and National Association of Accountants.

The AAA has for several years appointed ad hoc committees to review drafts of various APB opinions

and research projects. This has led to the current pattern in which the review takes place at a much earlier stage than when the procedure was first started. It is now possible for the reviewing group to make constructive comments while an opinion is being formed rather than merely being complimentary or critical of that which has already been committed for publication.

The APB is organized into subcommittees assigned to develop point outlines, discussion outlines, and drafts of opinions for topics under consideration by the Board. Many of the cooperating organizations have named committees to correspond with the APB subcommittees so that they are available to review and give timely comment on the work in progress. The charter and operating policies of the APB have been changed to acknowledge this cooperative effort and to advance it by removing most Board materials from a confidential status.

The Board is committed to this cooperative review. The whole exposure process gives evidence of the interest it has in obtaining the views of interested parties. Each member of the APB is supplied with a copy of each letter of comment received on a research study or draft opinion. In one case, over 1,000 such letters were received. Although this can become some-

what burdensome for members of the Board, it is an essential part of their task. They are warned at the time they are appointed to the Board of the demands they will face and so are prepared to spend the time required.

The Board faces a dilemma in respect to "comment from other groups and individuals." Some say the APB has not heeded comment in making its final pronouncements. On the other hand, the Board is often criticized for listening too much, or -- stated in another way -- for yielding to pressures. Such criticism is to be expected where the issues involved are controversial.

By the very nature of its task, the Board exposes itself to criticism. Comments and opinions of others are useful and needed, but Board members must make final decisions in their responsibility to serve the public interest.

Cooperative efforts are healthy and constructive, but they do involve time and administrative effort. While a reasonable price to pay, there is the possibility of this circumstance being used to delay or prevent Board action. This we must work to avoid. The cooperative efforts should be used in good faith by all sides.

Time Schedule for the APB. The current agenda of the Accounting Principles Board is heavily laden with important subjects. No less than five topics are scheduled for final opinions by late 1969 or early 1970. These include accounting for leases, equity accounting, accounting changes, reporting of diversified companies, and -- most urgent of all -- accounting for mergers and goodwill. In addition, the prospects are that the Board will issue a statement on price level adjustments around mid-year.

This is an impressive schedule. The Board has adopted probably the most demanding program since its formation for dealing with the problem of mergers and goodwill. Recognizing the serious problems that exist in this area, the SEC among others, has been outspoken in its desire for early APB action. Unless a definitive APB position is reached by the end of 1969, the SEC might well establish its own accounting rules for mergers. A report on the current thinking of the SEC staff already has been filed with a Congressional committee and made known to the accounting profession.

The SEC has also made proposals for product line disclosures by diversified companies in their registration statements and is almost sure to put

these proposals in final form soon. Because such disclosures would be required elsewhere than in the financial statements, the APB has the opportunity to spell out product line reporting requirements for fair presentation of financial statements. This opportunity may not last long. It is likely that a Board pronouncement on this subject would call for some disclosure of profit by line of business.

The other topics -- leases, equity accounting and changes in accounting method -- also deserve high priorities. Although not debated as widely and given as much publicity as the two I have discussed, Opinions on these subjects will nevertheless make important improvements possible in financial reporting.

New Developments at the Institute. To aid in expediting its projects, the Institute is planning to add to its staff more people to work on drafting and research for APB Opinions and Statements. Another CPA has been employed to work with the APB primarily on the drafting of documents. We also have commenced a new activity -- that of issuing Unofficial Accounting Interpretations.

The Institute staff is assuming the major burden in preparing interpretations. The staff may learn of subjects needing treatment as a result of

inquiries from outside sources. However, the APB itself and its individual members are expected to be primary contributors of subjects requiring attention. Some subjects may be considered at Board meetings, or in subcommittee meetings, thus directing a responsible consensus to the problem. In other cases, the Institute staff may undertake research and make inquiries to establish the soundness of a proposed Interpretation.

The staff will then draft an interpretive comment, and review it with the Chairman of the APB, and with the Executive Vice President. This new Institute staff position on accounting interpretations has been filled and the first study is in process.

On approval, the Interpretation will be published in the Journal of Accountancy, so that all Institute members will have access to it. At some future time, Interpretations are expected to be included in the CCH loose-leaf service, along with APB Opinions.

An appropriate disclaimer will accompany Unofficial Accounting Interpretations to describe their tentative nature. Future APB Opinions may supersede some Interpretations, and in such cases the superseded material will be withdrawn.

The technical efforts of the Institute are

not limited to accounting principles. Although not receiving as much publicity outside the profession as the effort to define accounting principles, statements on auditing procedure and audit guides have a very important impact on the reporting of corporate results and in assuring audit work of high standards. This activity has not been supported by Institute staff to the extent of the work on accounting principles, but measures are being taken to remedy this imbalance. A manager for auditing research will join the staff this summer to handle this work. Still other positions supporting the auditing procedures committee are being planned.

Increased Research Efforts. Last year Marvin Stone, then president of the Institute, spoke to this Conference about "Problems in Search of Solutions Through Research." He commented on the report of the Institute's Planning Committee which recommended a far-reaching research program. One of the initial steps proposed has been carried out. This is the appointment of a Research Committee, with Marvin Stone as its chairman, and with members representing various segments of the profession.

The committee has had two meetings and is now

concerned with various research proposals, with financial arrangements for additional research, and with long range plans for broadening the research program of the Institute in line with the Planning Committee's recommendations.

In its initial discussions the Research Committee has recognized that the Institute cannot expect to engage in all the research that might be desirable. We hope, however, that arrangements can be made for more cooperative effort and at least some "clearing" of projects in process so that duplication can be avoided and money saved. This is in line with Sidney Davidson's suggestions to the Council of the Institute in his capacity as President of the AAA.

Although money is one of the scarce factors in the research area as far as the Institute is concerned, probably an even more scarce factor is that of manpower. The Institute intends to have a very respectable staff research capability and to use outside services as well.

With regard to the latter, a contract has been made with Stanford University for a special study.

In this case the Institute was interested in sponsoring a research project that would examine the

broad area of basic cost concepts and implementation criteria. This might in turn have implications for several current problems facing the profession relating to cost measurement.

The development that motivated our interest was the General Accounting Office's feasibility study on uniform cost accounting standards.

Under the Institute's study, a team of five professors at Stanford University will spend the equivalent of three full man years of work on the project. The prospectus for this study was published in full in the February Journal of Accountancy. Although the final study will not be completed until 1971, the team has agreed to provide an interim report in late 1969 which may be helpful to the GAO task force working on the uniform cost accounting standards feasibility study.

Not to be overlooked in the research area are the facilities at other universities.

The University of Chicago has been in the forefront of research in accounting through its faculty-graduate student research program by means of this annual conference on empirical research, the accounting research data bank, and publication of The Journal of Accounting Research. Other universities are directing

accounting research into areas which are for the most part complementary to rather than competitive with the Chicago efforts. This is all to the good.

Perhaps the most intriguing, and at the same time the hardest to evaluate of the Chicago projects is the data bank.

The Institute is concerned over the need for a profession-wide information retrieval system. Planning to meet this need is in a very early stage, and we have yet to define a possible relationship between it and the University of Chicago data bank. The Institute Executive Committee has voted a sum of money to help support the first two years of the data bank. If a broader system is forthcoming in the future, the Chicago data bank may well be coordinated with the total system.

Meanwhile, other research efforts are bearing fruit. The Institute's Accounting Research Division has several projects that are nearing completion. They include accounting problems in the extractive industries, intercorporate investments, stockholders equity and accounting for industrial product research and development expenditures.

The research effort by the Institute and the APB is sometimes criticized by accounting scholars for being aimed at specific problems and having no

general frame of reference. For example, it is said they do not assume consistent behavior patterns in business and do not require uniform measurement methods. The APB is now following through on the Accounting Research Division's earlier efforts to provide a conceptual basis for accounting. It is well along in the preparation of a statement of "basic concepts and accounting principles underlying financial statements of business enterprises." This statement describes accounting principles and practices as they now exist.

It is the precursor of another research study, which has been authorized by the Board, called "Asset and Liability Valuation and Periodic Income Measurement". This study will be oriented toward "what should be" rather than toward a rationalization of current practice. It will deal with valuation systems other than historical cost. It will include examination of the replacement cost system, the market value system and the discounted net receipts system.

Results of this research are not imminent. Any benefits to be derived are far in the future. The important thing to note is that progress is being made toward acceptance of values in accounting.

In general, the practicing accountant has been

reluctant to accept anything other than historical cost. This is understandable in view of the many problems of determining values with objectivity. However, there are signs indicating that CPAs are amenable to a consideration of changes from the traditional historical cost basis of accounting. For example, although not a departure from the historical cost method, the fact that accountants are looking with some favor on adjustments for price level changes is encouraging.

In several specific areas departures from historical cost for special purposes have been recognized. The Institute's audit guide on personal financial statements recommends that: "additional financial information, setting forth the assets and liabilities on an estimated value basis, should accompany the financial statements presented on the cost basis." Some accountants were disappointed that the value basis was not prescribed as the only fair basis, but the fact that it is a recommended disclosure indicates considerable progress.

Another area where market value is gaining support for financial reporting is in insurance accounting. An Institute committee currently studying the problem of valuation of marketable securities has come out in favor of using year-end market values. The committee has said that ". . . generally accepted

accounting principles for investment gains and losses need to be reexamined and reestablished not only for insurance companies but also for all forms of business enterprises, except for mutual funds, and that such new principles should be universally and uniformly applied."

We are all aware, I am sure, of the changes that are taking place within the profession. The pace of change has quickened in the past couple of years. I have mentioned the new research efforts that are underway leading to improvements in financial reporting and in the professional standards of performance by its members. I am confident we will see more roots for new research being planted in the near future, since it is essential to have the findings of these deep investigations in order to reach practical and lasting solutions to our present and future problems.

I detect also a growing spirit of accomplishment among members of the Accounting Principles Board. They are realizing that, no matter how difficult their task is, solutions to what seem to be insoluble problems can be found. Others from outside the profession are joining in the effort, and this certainly is helpful.

The Board is breaking new ground in accounting theory and practice. With its present momentum, it is

gaining increasing respect from the financial community and from important segments of the public at large. Differences of opinion over major issues will continue to exist within and without the Board, but it is working today within a healthy environment in which continued progress can be expected. And rapid progress is essential if the task of raising accounting standards is to remain in the private sector.

#