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## TWO EXPOSURE DRAFTS APPROVED BY APB

Draft Opinions which would require a company to use the equity method for reporting "substantial" common stock interest in another company and make a statement of source and application of funds necessary for fair presentation of changes in financial position were approved for exposure by the APB at its December meeting.

Copies of the exposure drafts will be mailed to all AICPA members within the next three weeks. Comments are due by March 1.

Equity Method: This draft calls for a company to report its proportionate share of income or loss in foreign subsidiaries, 50 percent owned companies, corporate joint ventures, and holdings of 20 percent or more. The equity method would also be extended to parent-company-only statements which are primary statements to stockholders.

The reporting of marketable common stock investments of less than 20 percent will be considered separately. At issue is how the realized and unrealized gains and losses should be reflected in the income statement -- on a yield basis, or recognized currently.

Source and Use of Funds: Opinion No. 3 recommended that a funds statement be included as supplemental information. The SEC now requires the inclusion of such statements in annual reports and registrations filed with the Commission. The draft Opinion would extend this reporting requirement to all financial reports to shareholders which present a balance sheet and income statement.

Imputed Interest: The Board also is considering a draft Opinion which would require imputing a realistic interest rate to long-term receivables and payables which would appropriately reflect the substance of transactions where the notes nominally bear no interest or an interest rate clearly below a reasonable rate (See ARA Newsletter, Oct. 28, 1970). As a preliminary to broad public exposure in the future, the Board is seeking informal comments from several financial and business organizations. Copies of the draft Opinion will be mailed to ARA members when it is available, upon request to the APB Administrative Director's office.

## REVENUE RULING ON LIFO INVENTORIES

Revenue Ruling 69-17, issued January 1969, permitted the use of the FIFO method for inventories in consolidated financial statements although the LIFO method was used by a subsidiary in its income tax return. Revenue Ruling 70-457, issued August 31, 1970, revoked Revenue Ruling 69-17 to require LIFO

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in consolidation if used by the subsidiary in its income tax return. The effective date of Revenue Ruling 70-457 has been extended so that it now applies to consolidated financial statements issued after August 31, 1971.

The APB recommends that when companies revert to LIFO for such subsidiaries, they should handle the accounting change as follows:

- The effect of the change to the LIFO method should be reflected in consolidated statements and earnings releases by retroactive adjustment to statements of prior years in which the cost of inventories was determined by FIFO or another method.

- Disclosure should be made in a note to the financial statements.

- The effect on fiscal year company statements should be reported in the next quarterly earnings release, where possible.

Because of this unique problem, the Board stated that this recommendation would not predetermine appropriate methods for reporting accounting changes, which are now under consideration by the Board (ARA Newsletter, Oct. 28, 1970).

Copies of a memorandum on the LIFO problem are available from the APB Administrative Director's office at the Institute.

## EXPOSURE DRAFT ON HEALTH AND WELFARE FUNDS

An audit guide covering special financial problems of health and welfare funds has been distributed for comment by the committee on health, welfare and pension funds. It would apply only to health and welfare plans which are funded in some definite manner, usually by employer contributions to a separate trust fund.

The guide describes the nature of such funds, discusses the applicable accounting principles and internal controls, and recommends procedures to be followed by the auditor in examining and reporting on the financial statements.

It proposes that accrual accounting be used because the cash or modified cash basis now used for many plans can, in many cases, result in an "incomplete presentation" of financial position. Under the accrual method, contributions receivable from employers would be reported in the financial statements. Also, the guide states, "the fund should adopt internal control procedures which are adequate to disclose and follow-up delinquent employer reports and contributions as well as employer over or underpayments."

Review copies of the exposure draft, on which comments are due by January 15, are available from the Institute's Technical Services Division. Final recommendations are expected to be issued in the spring.

## STATEMENT ON AUDITING PROCEDURE FOR ARTICLE 5A COMPANIES DEFERRED

A proposed SAP for Article 5A companies has been postponed pending a comprehensive study by the committee on development stage companies. This action was taken because the auditing procedure committee believes that the reporting problems can not be resolved until some accounting questions have been answered. After the committee reviews the study results, which should be available in July 1971, it is expected that a statement will be issued which will reduce the diversity of reporting on financial statements prepared in the 5A format.