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Leonard M. Savoie

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INTRODUCTION

The need for narrowing areas of difference in accounting practice has been so amply demonstrated that the remaining controversy centers largely around how it is done and what effect this will have on business. The accounting profession has quite rightly taken the position that financial statements are representations of business management and that the independent accountant assumes a separate responsibility in expressing an opinion as to whether these statements are in conformity with generally accepted accounting principles. The Accounting Principles Board is seeking to establish, amplify, and clarify these principles in order to provide more substance and meaning behind the opinion of the accountant. In doing so, the Board has tried to involve business management to a greater extent. The reasons are these:

First, there is a real need for management to recognize clearly that the statements are theirs and they should be concerned over the accounting that is followed and the credibility with which the statements are received.

Second, corporate financial management contains a vast pool of knowledge on accounting and financial reporting matters which must be made available to the Board if it is to establish principles wisely.

Third, management must be involved in determining accounting principles to provide assurance to all that the Board is not acting arbitrarily without regard to real practical problems.

It is plain that management is becoming very much interested in the work of the Board. In September, more than 7,000 copies of an exposure draft of a proposed opinion on income tax accounting were sent to corporation presidents, university professors, bankers, financial analysts and other business leaders. Nearly 1,000 letters of comment were received, representing collective views of thousands. As expected, most of the comments were critical. It is only natural that those who object to proposed rules make their views known while those who approve remain silent. But the income tax opinion was destined to attract an unusually large storm of protest, for it attempted to deal with accounting for investment tax credit, a controversial and emotion-charged issue. Many respondents have stated that this issue should not have been raised again, for industry has predominantly followed the flow-through method.

Now, our 20/20 hindsight reveals plainly that the request for comment on the exposure draft should have been accompanied by an explanation of why the opinion was prepared and what was expected to be accomplished. Improved communications would have eliminated some, but certainly not all, of the protests. It would have been helpful to explain that the thorny subject of accounting for income taxes was tackled by the Board because it is an important and unsettled area where differences in accounting practice should be narrowed. And narrowing differences is certainly responsive to the prodding the Board has received from financial writers, financial analysts, the SEC and others, including some business men. It would have been helpful to point out with regard to the investment credit --

(1) That it is an important part of the overall problem of accounting for income taxes that properly should be treated in an opinion on income taxes,

(2) That it is an area where informed opinion is nearly unanimous in agreeing there is no logical justification for the existence of more than one accounting method,

(3) That the 1962 opinion of the Board achieved limited acceptability in practice largely because of the lack of support from the SEC and certain large accounting firms, and the Board was forced to recognize this situation in a March 1964 opinion,

(4) That in October 1964 the authority of APB opinions was greatly strengthened by the adoption by the governing Council of the American Institute of Certified Public Accountants of a Special Bulletin calling for disclosure of departures from opinions of the Accounting Principles Board, and therefore a strong pronouncement now would be assured of greater acceptability,

(5) That since the enactment of the investment credit for the first time in 1962, the Board has consistently favored the deferral method by a two-thirds majority and therefore in their view, the October 1966 suspension of the investment credit followed by the March 1967 reinstatement with the maximum available credit raised from 25% to 50% of income tax would greatly increase the over-statement of corporate income if the flow-through method were used, and

(6) That the SEC supports the proposed opinion.

Hindsight also leads us to the conclusion that the exposure draft lacked clarity as to its applicability to items that are immaterial. There was no intention to deviate from the Board's standard of non-applicability to immaterial items. Yet the proposed opinion clouded this issue by references to "all" timing differences and by introducing new terms of art such as "comprehensive tax allocation" and "partial tax allocation." "Comprehensive" was interpreted by some as meaning "all" with no exception for immaterial items. "Partial" was interpreted by some as meaning all items that are material in amount, whereas this is not what is meant.

The Board might also have pointed out in its request for comments on the exposure draft the long and careful process that is followed in arriving at an opinion. This might have avoided charges that the Board is acting hastily. Allocation of income taxes is an accounting practice that has evolved over a period of some thirty years or so in response to a need to properly match income tax expense with the revenue giving rise to the tax. It has also been the subject of several pronouncements by the Board's predecessor, the Committee on Accounting Procedure. In the early sixties, a research project was authorized on the subject of accounting for income taxes. This culminated in the issuance by the AICPA Accounting Research Division in May 1966 of Accounting Research Study No. 9 by Professor Homer L. Black. Shortly after this a subcommittee of the Board began developing a point outline for consideration by the full Board. After debate of the point outline, a first draft of an opinion was prepared by the subcommittee and debated by the Board. Many revisions were made and many further discussions of accounting for income taxes were held by the full Board. During this past July and August, the subcommittee held meetings with some 24 different industry and government groups to discuss the main points in the tax opinion. Following this, another draft was prepared and approved for exposure.

I mention these procedures in some detail to give you a better idea of the deliberative processes followed by the Board. The Board is not tallying votes in a popularity contest. If this were its approach, it never would issue an opinion.

What weight can and should the Board give to the comments received, mainly from industry and mainly negative? Quite obviously, many of the views are sincerely-held beliefs based upon reasoning that has some merit. But just as obviously, many respondents have an eye on earnings per share, a fear for the loss of an advantage now held, and inadequate understanding of what the Board's opinion really says.

Nevertheless, the many comments received and to be received on any proposed opinion must be studied carefully and weighed by the Board as to their merit. In particular, those which offer new problem situations or new slants to an old issue must be considered as to possible changes that may be appropriate to accommodate them. On the other hand, the Board must reject the comments which simply repeat old arguments that have been thoroughly explored, researched, debated, and rejected. It is not easy for individual Board members to determine which of a myriad of suggestions require changes in a Board position and which suggestions must be rejected in the interest of fairness and consistency, and usefulness to investors.

The Board faces a number of basic problems in carrying out its duties. In the first place, changing conditions present new tasks. The proliferation of private pension plans, the merger movement, or changes in the tax structure -- all these things bring accounting problems in their wake.

In the second place, the fact that accounting principles are a product of intellect and cannot be checked against external nature, makes differences of opinion within the profession itself virtually inevitable.

Finally, the Board's efforts to improve and rationalize accounting principles often provoke strong reaction in the business community.

CONVERTIBLE DEBT

The income tax opinion is not the only one that has provoked strong reaction. The year 1967 also saw strong opposition to the APB arise in connection with another accounting problem. The Omnibus Opinion issued a year ago calls for the allocation of a portion of the proceeds received for bonds convertible into stock, or bonds issued with warrants to purchase stock, to the conversion privilege or to the warrants. This accounting results in an additional imputed bond discount that has to be amortized against income as long as the bonds are still outstanding. Application of this accounting method to bonds issued with warrants has caused no difficulty at all. But use of the method for convertible debentures brought forth from investment bankers and others a storm of protest -- and some new information on the subject. As the issue is very complex, it is back for restudy by a subcommittee of the Board, with a definitive pronouncement promised by the end of 1968. In the meantime, companies may follow the accounting called for by Opinion 10, but if they do not, they will have to show on the income statement a supplementary proforma earnings per share figure adjusted for the dilution that would occur if the debt were converted.

FINANCIAL STATEMENTS OF BANKS

Still another example of industry opposition to improved financial reporting can be found in the case of commercial banks. Here, not the APB but a separate Committee on Bank Accounting and Auditing has had a bank audit guide in the course of preparation for about ten years. The length of time required reflects the difficulty of getting agreement on accounting principles among the CPAs on the Committee as well as continued opposition from the banking industry and the bank regulatory agencies. Meanwhile, bank financial statements put banks among industries with the poorest financial reporting to investors. Bank statements do not even present a figure for net income. But those bank financial statements examined by CPAs will soon have to show net income and reflect a number of other accounting improvements. For the Committee has finalized its bank audit guide; it is now at the printer and will be distributed in March. The APB is expected to take the necessary action to make its Opinion on Reporting the Results of Operations applicable to bank financial statements.

TOWARD GREATER COMPARABILITY

Notwithstanding its trials and tribulations, the Accounting Principles Board is persevering in its study and tightening of accounting principles. The profession is confident that, by holding fast to its aim of serving and protecting the public, it is helping to preserve and strengthen the free enterprise system.

But we have no doubt that unless continued progress is evident -- unless unnecessary obstacles to comparison of earnings per share are eliminated -- public criticism will be revived and the SEC will press for results.

I should make it clear at this point that neither the Institute nor the SEC has the objective of rigid uniformity in accounting. The objective is to eliminate alternative accounting treatments not justified by differences in circumstances -- and to specify criteria for determining when different accounting treatments do apply.

Absolute comparability of earnings per share will probably be unattainable, because there will always be an element of judgment in the application of accounting principles, even though the principles themselves are fairly standardized. But we believe that the investing public will insist on the elimination of unnecessary and confusing differences in accounting which increase the difficulty of making reasonable comparisons among companies as a basis for investment decisions.

CONGLOMERATES

Many thorny problems are on the APB agenda for the year ahead. One is the subject of disclosures of financial information by segments of diversified companies.

In September of last year, the Board issued a Statement, as distinct from an Opinion, on this subject urging diversified companies to consider reporting supplemental financial information on segments of their business that are clearly separable into different industry lines. Before recommendations can be made as to how much of this kind of information, if any, should be reported, additional facts must be determined by research and practical experience.

This is an area in which more definitive reporting methods may be forthcoming at a future time. It is an example of an economic development requiring new accounting guidelines -- and it is also an example of a controversial area where strong industry opposition has already shown up.

BUSINESS COMBINATIONS AND GOODWILL

Falling in somewhat the same category is the problem of business combinations and goodwill. The current wave of business acquisitions and mergers could not have taken place without the tax laws permitting tax-free exchanges and the almost complete freedom of management to choose between purchase accounting and pooling-of-interests accounting. The AICPA's Accounting Research Division will in a very few months issue a major research study on accounting for business combinations and goodwill. At that time, or perhaps even sooner, a subcommittee of the Accounting Principles Board will begin developing points for decision in preparation for drafting an APB Opinion. I would not hazard a guess as to the Board's ultimate solution of this problem. But any recommendation that is more restrictive than our present loose guidelines will surely spark heavy opposition -- particularly from merger-minded companies. Tightened accounting principles may well shape the nation's trend in corporate mergers.

PRICE-LEVEL ACCOUNTING

Still another major subject before the APB is price-level accounting. The Board has a proposed Opinion nearly ready for outside comment -- it should be exposed by summer. And this could prove to be a very timely issuance. Accounting does not now recognize the declining purchasing power of the dollar, even though inflation has occurred during most of the last thirty years. Following a major research study on this subject, the Board has developed a draft Opinion which will recommend supplemental disclosures of key financial information adjusted in terms of a constant level of purchasing power. The draft Opinion contains detailed steps for guidance in applying the technique of price-level adjustments. There is little doubt that for most companies price-level accounting will produce significantly different operating results than historical-cost accounting. Will this be accepted? Will companies make the recommended supplemental disclosures? We hope they will as the additional information can help greatly in analyzing a company's performance. But with lower earnings to be reported by most companies, we can look for resistance ranging from mild and passive to strong and highly vocal.

A FULL APB PIPELINE

The APB pipeline is also full of a number of less exotic subjects that are expected to yield improved accounting in the near future. One such project involves determination of criteria for applying changes in accounting methods -- i.e., what changes should be reflected in income of the current year, prospectively over future years, or retroactively in past years? Other projects relate to such troublesome problems as developing recommendations for accounting for industrial product research and development expenditures, and specifying preferred accounting treatment for problems peculiar to the extractive industries. There are many other subjects on the very full agenda of the Accounting Principles Board and the Accounting Research Division, but the foregoing gives a good idea as to the nature and significance of their work.

Controversy is not new to the accounting profession. The thing that is new is operating in a regulatory capacity in a public arena where there are strong pressures from widely varied sources. We have a lot to learn about how to operate effectively in this environment.

If there is a common experience running through the problems of raising technical standards of the profession, it is that in the face of an irreversible trend toward tighter accounting standards, there persists in some quarters a reluctance to move ahead from the status quo. It seems to me that business should be willing to accept principles thoughtfully and painstakingly worked out by the accounting profession as a part of our private enterprise system in preference to regulation that might well otherwise be imposed by government. There is nothing penal about accounting principles that are made applicable fairly and uniformly to all companies. Regardless of how business men may react to the profession's attempt to narrow differences in accounting practices, the only danger to the profession -- and to business as well -- lies in inactivity. As illustration, one has but to recall the APB's 1965 withdrawal of a proposed pronouncement on classification of deferred taxes installment sales and the resolution of this issue in the SEC's Accounting Series Release 102.

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I have tried to convey to you in a few words the seriousness of purpose of the work of the Accounting Principles Board, the increasing involvement in these matters of the business community, and the great need for independence, objectivity and integrity in dealing with these problems. We must be concerned with the public interest.

In carrying out its responsibilities, the accounting profession might well take heed of these words addressed to Wall Street recently by Robert W. Haack, new president of the New York Stock Exchange:

> "Vast public interest must be encouraged with renewed vigor and in healthy and constructive ways. When public interest and private interest do not coincide, I submit that the public interest, properly defined, must prevail. The public may be willing to forgive us for mistakes in judgment, but it will not forgive us for mistakes in motive."