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American Management Association American, New York, April 26,  
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THE AICPA AND NEW ACCOUNTING GUIDELINES

by

Leonard M. Savoie

before

The American Management Association

American Management Association Headquarters  
New York  
April 26, 1971

## THE AICPA AND NEW ACCOUNTING GUIDELINES

I am aware that I am speaking to representatives of a group that has played an increasingly important role in financing the industrial development and expansion of this country. In 1969 over 43% of the life insurance industry's total assets of \$197.2 billion was invested in stocks and bonds of industrial, public utility, and railroad companies.

Even more impressive is the growth of this involvement since the end of World War II. In 1950 the market value of investments held by life insurance companies in common and preferred stocks amounted to \$2.1 billion. At the end of 1969 these equity investments climbed to \$13.7 billion, an increase of \$11.6 billion. Over the same nineteen year period investments in corporate bonds increased by \$48.3 billion, from \$23.3 billion in 1950 to \$71.6 in 1969. Although some of this growth results from higher market values, growth, measured in real-terms, has been significant.

As you no doubt realize, a distinguishing characteristic of the American economic system is the extent to which it relies on a constant and readily available stream of financing. This financing maintains and expands facilities of production and distribution which in turn generate greater monetary rewards to business, employees and shareholders. Economic stimulus creates increased

demands for production and, correspondingly, for additional capital which is derived from investors -- individual and institutional -- and credit grantors.

With few exceptions, life insurance companies and other segments of the capital markets of the United States have generated financing in sufficient quantities to sustain an accelerating gross national product. They appear capable of meeting the financing demands of a trillion-dollar economy.

Basic to our capital needs is public confidence in the reliability of financial information. If confidence were seriously impaired, the viability of our economic system would be gravely diminished.

A guiding factor in creating and maintaining confidence in corporate financial information is the accounting profession. The profession does this in two ways.

First, it establishes the accounting principles upon which financial statements are based. This role has been undertaken by the American Institute of Certified Public Accountants through its Accounting Principles Board, which furnishes guidelines for practicing CPAs and the business community.

Second, the independent CPA follows these guidelines in expressing to investors, credit grantors and the general public his professional opinion on the fairness

of financial statements presented by management. Ordinarily the Securities and Exchange Commission and stock exchanges will not accept financial statements that contain anything other than the auditor's unqualified endorsement.

These two factors -- establishing accounting principles and attesting to the fairness of financial statements -- are basic in maintaining public confidence in our economic system.

The Accounting Principles Board is supported by the governing Council of the Institute through a resolution obligating members to see that the principles contained in APB Opinions are followed or that departures from them are disclosed. In practice, Opinions of the Board also are supported by the SEC and stock exchanges.

Therefore, the work of the Institute in this area is obviously a matter of public interest. It should also be a matter of special interest to the life insurance industry as a major investor which in turn looks to its policy holders and stockholders for its source of capital.

The APB has a great variety of subjects before it, most of which deal with broad accounting issues that apply throughout industry. But the APB has neither the time nor the special expertise needed to deal with all of the industries which have specialized problems. Therefore the Institute's program for improving accounting standards also includes a series of audit guides for specific industries which deal with both accounting and

auditing matters. These guides are prepared by committees of Institute members who are especially familiar with the particular industry. To assure consistency of accounting principles, an audit guide is released only after being reviewed by the chairman of the APB for overall conformity to the more pervasive pronouncements of the Board.

As you know, an exposure draft of an audit guide for the life insurance industry was issued in January for comment from interested persons. That draft is a primary focus of attention at this briefing session.

Audit guides do not have quite the same authority as APB Opinions -- that is, disclosure of departures from audit guides was not covered by the Council resolution. Nevertheless, audit guides are highly authoritative and they are expected to be followed. Each guide contains a notice that Institute members should be aware that they may be called upon to justify departures from the guide's recommendations.

In view of the importance of APB Opinions and Institute audit guides to industry and the investing public, the Institute has become increasingly concerned about the way in which accounting principles are established. As a result of this concern, the Institute has just formed two high-level groups to study ways for it to improve its function of setting standards of financial reporting. One group will study how accounting principles should be estab-

lished and the other will seek to refine the objectives of financial statements.

Each group contains representatives of business and professional life outside public accounting. In fact, a majority of those on each study group is from outside public practice. The group studying the establishment of accounting principles is chaired by Francis M. Wheat, a recent member of the Securities and Exchange Commission and a distinguished lawyer now practicing in California. Serving with Mr. Wheat are a university professor, a financial analyst, a financial vice president of one of the nation's largest industrial corporations, and three CPAs engaged in the practice of public accounting.

The group studying the objectives of financial statements is chaired by Robert M. Trueblood, an outstanding practicing CPA and a past president of the American Institute. Serving with him are a financial analyst, an economist, an industrial executive, two professors, and two CPAs from public practice -- each of whom was selected for his wide range of experience and known abilities in financial and accounting matters.

I am convinced that the work of these two study groups will strengthen the accounting profession in its service to the public. The study on establishment of accounting principles is expected to be completed within 6 months and the study on objectives within 18 months.

Meanwhile, the Accounting Principles Board and special industry committees have been developing operating procedures to assure the consideration of all points of view. When preparing pronouncements, the Board and committee members directly responsible seek out early opportunities to exchange views on problem areas with representatives of responsible professional and industrial associations. A formal public exposure process is followed and comments received are carefully considered. Seminars are held to consider controversial issues -- and nearly every pronouncement involves controversial issues. The Institute is moving toward broadening these seminars into public hearings.

One such hearing, scheduled for May 25 and 26 here in New York, will be of interest to the life insurance industry. This meeting will consider the subject of accounting for marketable securities, a good example of a problem area that affects many industries but is also of more special concern to a few. Therefore, the subject is before the Accounting Principles Board as well as the Institute committee on insurance accounting and auditing.

The major question involved is whether marketable equity securities should be carried in balance sheets at market value with unrealized increases and decreases in value included in net income.



Conceivably the APB could issue an Opinion that would (a) apply to all companies without exception, (b) contain different requirements for the life insurance industry than for other industries, in recognition of special circumstances, or (c) provide an exception for life insurance companies, thus handing the problem back to the committee on insurance accounting and auditing. It is important that the decisions of the APB and the committee on this matter be coordinated.

We expect the life insurance industry to be well represented at the forthcoming hearing.

Today's briefing session is outside the Institute's regular procedure for exposing proposed pronouncements and receiving reactions and comments. Nevertheless, we think this American Management Association session presents an excellent opportunity to broaden the exposure and public involvement process. We welcome the opportunity to have our committee chairman Ted Arenberg present the proposed accounting guidelines for the life insurance industry and to participate on a panel with leaders of the industry.

The accounting profession is deeply concerned with meeting its obligations to provide the highest attainable standards of financial reporting. But this goal cannot be achieved without the cooperation and participation of the business and financial community.

Meetings such as today's take important steps in that direction. With such cooperation, we, together, will continue to give the public the reliable information it deserves.

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