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The Woman CPA

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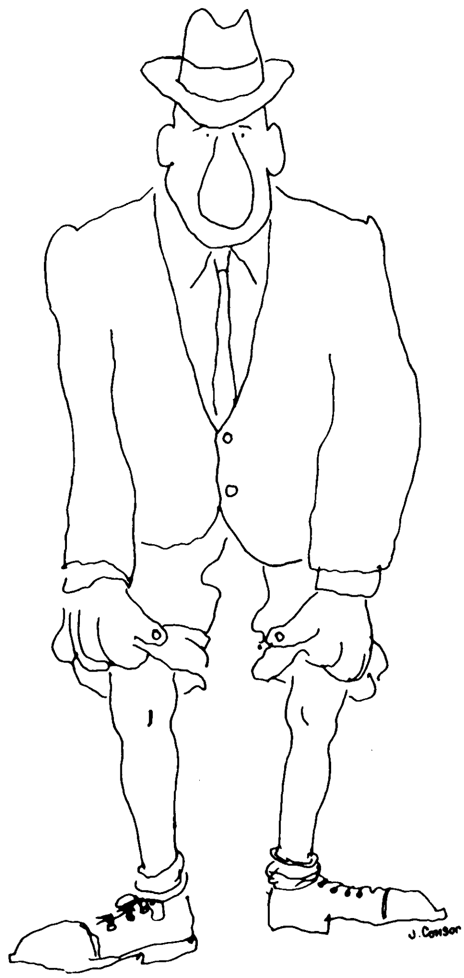

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The Woman CPA

April 1974 Volume 36, Number 2

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If It's Monday, This Must Be Touche Ross

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Dr. Mary Lou Bryant

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The authors describe their experiences in taking a group of students to Europe to learn about International Business.

The next best thing to going to Europe for the fun of it is going to Europe and being able to deduct it on your tax return. Or so we thought last June, when we decided to offer an experimental course in International Business during the January 1974 intersession at the University.

Fortunately we had no idea of the work such a trip would involve, so we plunged right into it and didn't come up for air until we arrived in London in January. For anybody interested in organizing or taking such a trip, here is a short synopsis of how we planned it and what we learned.

The Planning

First of all we decided to confine the venture geographically in order to keep the transportation expenses down and yet visit as many centers of multinational corporations and international institutions as possible. That meant going to England, Belgium, the Netherlands, and the northwestern part of West Germany and eliminating such interesting places — by international business standards — as Paris, Frankfurt, and Zurich.

Then we looked at the calendar and set the departure date for January 3, so we would arrive in London on Friday, January 4, and have all weekend to get our biological clocks adjusted to European time. We chose London for our first European stop to lessen the culture shock for students who had never been abroad, since England is less different from the States than the European continent.

A week in London, we thought, would not be too long because London is the European financial center and the headquarters of many international firms. Because Belgium has the reputation of being very expensive (which we did not find to be true), we decided to spend only two days there and to devote the rest of the second week to Holland. Because West Germany is also reputed to be expensive (which we did find to be true), we scheduled only two days in Duesseldorf before dissolving the group and letting everybody do their own thing wherever they wanted to do it.

The next step was the selection of the firms to be visited. We decided at the very beginning that we would attract more students by offering a course in International Business rather than in International Accounting or International Management. Besides, the functional areas of accounting, finance, management, and marketing (to say nothing of economics) are so interrelated in international business that it is impossible to talk about one without getting involved in the others. As it turned out, the mixture of talks on different business functions was fortuitous and provided enough variety to keep everyone interested. Twelve days of nothing but accounting would have been dull — even for an accountant.

After we had made up a tentative list of organizations we wanted to visit, we selected the most promising way of contacting them. If one of us knew somebody in the European office we wanted to visit, we wrote directly to that person. If one of us knew somebody in an American office of a firm on our tentative schedule, we wrote or called that person. And if we knew nobody at all, we either wrote directly to the European office or we called the American headquarters or a division near us. Being located in the East and having a WATS line were distinct advantages here.

Virtually all the people we contacted here in the States wrote to their European representatives, urging them to grant our request for a visit. Only one firm (and it shall remain nameless) never answered our letters; all others responded promptly and favorably.

Every once in a while we ran into a snag, such as we did with Polaroid, a Massachusetts-based corporation, whose world advertising headquarters is in Amsterdam. Unfortunately, all their top advertising people were scheduled to attend a conference in London during the days we planned to spend in Holland. So we substituted the Heineken Brewery for Polaroid — a decision which was very popular with our students.

Because this was the first time we conducted the course, we were afraid that not enough students would sign up if our admission standards were too restrictive. Therefore we admitted juniors, seniors, and graduate students from the School of Business Administration and one student majoring in Hotel, Restaurant and Travel Administration. The reaction of the one HRTA student was that, even though he learned a lot, he was unable to profit fully from the course since his knowledge of business subjects was somewhat deficient. Based on the participation and reaction of the other students, we have come to the conclusion that future trips should be restricted to seniors and graduate students in business.

Although we had some preliminary meetings and had prepared an extensive reading list, we found many students unaware of the complexities of international business. Therefore they could not take full advantage of the opportunities offered by the course. For future trips such as this one we may give preference to students who have completed a course which focuses on the international dimensions of business operations. For example, a course in International Accounting, International Management, or International Business would fill this need. As an alternative to a prerequisite course we are considering offering several informal orientation sessions concentrating on basic international business concepts as part of the course.

In all our initial contacts with the firms we planned to visit, we stressed the educational level of our students in order to make sure that the talks would be on a technical level. All the speakers took us at our word and pitched their talks to a sophisticated level, thus making them much more interesting. Only a few talks included too much technical detail for the students not majoring in that particular subject. By and large the level of discussion corresponded to the level of knowledge of our group.

Break during A.C. Nielsen meeting in the Amsterdam Hilton.

Arrival at Duesseldorf railroad station.

For the travel and hotel reservations we found a local travel agent who was tearing out her hair while making out the airline tickets in December when the transatlantic fares changed every other day. The cost per student was $530. That included all transportation expenses from Boston and back (on 22-45 day excursion tickets), as well as hotels with breakfast from January 4 to 22.

The Itinerary

Our final schedule of firm visits was as follows:

London –

Jan. 7 — Coopers & Lybrand
8 — London Stock Exchange
Bank of England
9 — Continental Illinois National Bank
Royal Dutch Shell
10 — Gillette
11 — Ford of Europe

Brussels –

Jan. 14 — European Economic Community
Touche Ross & Co.
15 — Procter & Gamble

Netherlands –

Jan. 16 — Philips Lamp, Eindhoven
17 — Young & Rubicam, Amsterdam
A. C. Nielsen Co., Amsterdam
18 — Heineken Brewery, Amsterdam

Duesseldorf –

Jan. 21 — Dresdner Bank
Duesseldorf Stock Exchange
Foreign Exchange Market
Jan. 22 — Treuarbeit
McKinsey & Co.

The Trip

Of the many pleasant surprises we had on the trip, the first one was that the twenty-one students who assembled in the London hotel lobby on January 7, our first official day, were the same twenty-one people who had signed up for the course way back in September or October.

The second surprise came when we were greeted by Coopers & Lybrand in London and lasted throughout the trip until we said Auf Wiedersehn to McKinsey & Co. in Duesseldorf. We had already been pleasantly surprised by the cooperation we received from the firms while the trip was still in the planning stage. (The Dresdner Bank in Duesseldorf, for instance, found a hotel for us when the hotels there didn't answer the letters from our travel agent.) But that was nothing compared to our surprise when we actually arrived. The time and thought every firm had put into preparing for our visit exceeded our wildest expectations.

It is difficult to remember now what we did expect when we first wrote and suggested topics for discussion. But we certainly would not have been astonished if experts on the middle management level had talked to us about their work for thirty minutes or so and had then answered our questions. What we found instead were many top executives giving us extremely well prepared presentations, often with explanatory slides, charts, and film clips which were quite obviously tailor-made for the subjects of their talks. And in virtually every case we had suggested the subject — not the firm we visited. So we couldn't have gotten a talk which had been prepared some time ago for some other group and which had been taken out of the drawer and dusted off for us.

To recapitulate the contents of all the talks we had with the nineteen firms we visited would take a whole issue of this journal. So here, instead, is a short list of the ideas presented which our students found most interesting.

Coopers & Lybrand. Sir Henry Benson, partner and chairman of the International Accounting Standards Committee, told us about the formation of that committee and the work it is currently doing. The three topics in various stages of preparation, we learned, are the valuation of inventories, consolidation practices, and disclosure of accounting policies. He was hopeful that the committee would achieve its goals since the nine organizations (including the AICPA) signed an agreement "to ensure that, as soon as practicable, appropriate action is taken in respect of

Group evacuating Continental Illinois Bank after bomb scare

auditors whose audit reports do not meet the requirements" of the standards promulgated by the committee.

Of all the talks Coopers & Lybrand gave to our group, the most impressive, according to our students, was the one about their part in analyzing the feasibility of the proposed tunnel under the English Channel. A member of the C&L staff told us how they used past travel and freight patterns and interviews with Britons to develop models for projecting the usage and income of the tunnel. The presentation also illustrated how historical data were used to validate the models.

London Stock Exchange. Unfortunately we got the canned talk which is piped through the loudspeakers in the visitors' gallery and the film which is shown at regular intervals to all visitors. Both the talk and the film assumed little or no knowledge of financial and business matters on the part of the visitor, so our students found them rather elementary.

Bank of England (also known as The Old Lady of Threadneedle Street). The topic of discussion was the European Economic Community (EEC) which England joined a year ago. Our speaker was an economist who explained some of the goals of the EEC, such as mobility of labor and fixed exchange rates among the currencies of the nine member countries, and the possible consequences to the attainment of some of these goals. If, for instance, the fixed exchange rates are achieved before labor mobility is sufficiently increased, a member country could find itself with an unacceptable rate of unemployment which it might want to alleviate through lower interest rates. But the question is whether the country's private capital will then be used for investment in capital assets or moved to another country to earn a higher rate of interest.

Continental Illinois National Bank. Arab money and its influence on the European money markets was the major topic. The discussion centered on the serious disruptions which would occur if Arab funds were withdrawn from the market. However, the bankers we talked to were confident that the Arab governments would seek sound financial advice and consequently not use their foreign exchange holdings as a political weapon.

Royal Dutch Shell. The energy crisis was, understandably, *the* topic of discussion. The most provocative idea presented to us was the concept of a backward-bending supply curve for Arab oil. In classical economics an increase in price leads to an increase in supply. However, this relationship may not hold for Arab oil (i.e., as the price of oil increases, its supply may decrease) due to the inability of many Arab countries to spend more money. If, for instance, the money is distributed to the citizens, their incentive to work — especially at jobs with low status and low pay — will be diminished. This would mean that foreign workers have to be imported for these jobs, and eventually the citizens might find that they are a minority in their own country. Using the money to improve the country's infrastructure also presents problems. This is due to the shortage of professional people, such as architects and engineers capable of drawing up plans, and skilled workers, such as heavy equipment operators and masons capable of executing them. In addition, it must have occurred to some Arab governments that their positions of power might be undermined if they raise the standard of living and educational level of the population.

Gillette. We had asked the company to talk about adaptations of its marketing strategies to the different markets it serves in Europe, Africa, and the Middle East. We got a fascinating account of how Gillette converts rural Africans from scratching off their whiskers with a piece of bone to shaving with a Gillette razor and blade. This conversion has to go hand in hand with the creation of a sales organization capable of functioning in countries with few roads and largely rural populations. Packaging, advertising, and displaying the product have to be done in many languages as well as conform to local habits and tastes.

We also got an insight into the difficulties of registering a U.S. trade name in foreign countries — difficulties which sometimes force a producer to sell the same product under different names in different countries.

Ford of Europe. We heard a very interesting talk about the difficulties Ford encounters in coping with the variety of automobile safety standards existing in the nine Common Market countries and the efforts underway to create common standards for all EEC countries.

Here we also heard for the first, though not the last, time the expression "N.I.H." which stands for "Not Invented Here" and expresses the attitude of many European nationals (and Americans?) towards ideas coming from another country.

European Economic Community. The main idea in the air there (and on the front pages of many European newspapers) was Regionalization, i.e., the effort to bring less developed regions of the Common Market, such as southern Italy and portions of Great Britain, up to the level of the more industrialized regions. The big controversy is, of course, over who will pay for it and who will benefit from it and how much it is going to cost.

Touche Ross & Co. Since it was Monday, it had to be Touche Ross. We got an introduction to the *Proposed Statute for the European Company* which has been in the works for several years. Two features of this Act stand out because they depart from business practices commonly accepted in the U.S.: 1. The Act requires that employees be represented on the board of directors, and 2. it permits the use of replacement cost in financial statements — surely a radical idea for American accountants.

Procter & Gamble. As we did with Gillette, we asked Procter & Gamble to tell us about adaptations of their marketing strategies. To our surprise we found that P&G and Gillette took different approaches. Whereas Gillette tries to change people's habits, P&G accepts the habits and changes its products. As everybody in Europe knows, the only way to get laundry whiter than white is to soak it first and then to wash it in boiling water. The washing machine producers accepted this European idea and build machines with two cycles: a pre-washing cycle and a washing cycle using boiling water. Procter & Gamble, faced with these different European laundry habits and washing machines, decided to change its product formulas to accommodate the existing market.

We also got an insight into how a TV commercial changes from country to country. We were first shown an Ameri-

Mr. Logue explaining Procter & Gamble's problems with brand names.

can commercial in which a sick wife explained to her husband how he could do all the laundry using the same detergent at different water temperatures. Because European husbands wouldn't be caught dead doing the laundry, the same commercial used two women, either mother and daughter (in Germany) or twin sisters (in Italy), to get the same point across. Obviously, the women's liberation movement has a long way to go in Europe.

Philips Lamp. Our introduction to Philips was a tour of the Evoluon, a round building containing several floors of interesting electrical and sound systems. On computers programmed for inventory control and cash management our students ran out of supplies and went into bankruptcy. And the professors? No comment.

In spite of the interesting talks we heard about Philips' replacement cost system and its models for capital investment decisions, our students were most impressed by a demonstration of Philips sound equipment. As we sat in the dark auditorium and heard music coming out of 150 loudspeakers placed all around us, we felt as if we were floating in a pool of music.

Young & Rubicam. European advertising was, not surprisingly, the topic. After an orientation to the world of advertising, several facets of this complex business were discussed in detail. A presentation on marketing research confirmed the impression left by some other companies that there is no "European consumer." For most products each national market must be surveyed to obtain the background information necessary to the launching of a successful advertising campaign.

The executive telling us about market research was, incidentally, the only woman executive we met during our entire trip. Judging by the answers we received to our questions regarding women in executive positions and by the impressions we got during the visits, the proportion of women in upper and middle management positions is even smaller in Europe than it is in the States. However, the fact that our group of students was directed by two women professors was accepted without any noticeable astonishment. Only a few times was our being women mentioned and that was invariably during a coffee or lunch break, when we were asked whether there are a lot of women professors teaching in American business schools.

At Young & Rubicam we also became aware of the many media, particularly in Holland, which are available for carrying advertising messages. One stark contrast to practice in the States is that advertisers have to buy time for TV commercials from the government a year in advance. The time of day when a particular commercial is shown and the commercials preceding and following it are all determined by the government, not the advertiser.

Mr. Trappeniers and Mr. Morris of EEC discussing Common Market policies.

Mr. Gwilliam and the authors outside the Continental Illinois Bank during the bomb scare.

A.C. Nielsen & Co. Instead of hearing about the famous Nielsen ratings for TV programs, we wanted to learn about the less well-known Nielsen market penetration surveys. We got an insight into the supermarket business in Europe and the difficulties of obtaining comparable data from different countries. This led to a discussion of the impossibility of determining market shares for products by countries given the fact that people living in border areas will shop on both sides of the border depending on price differences.

Heineken Brewery. Burp!

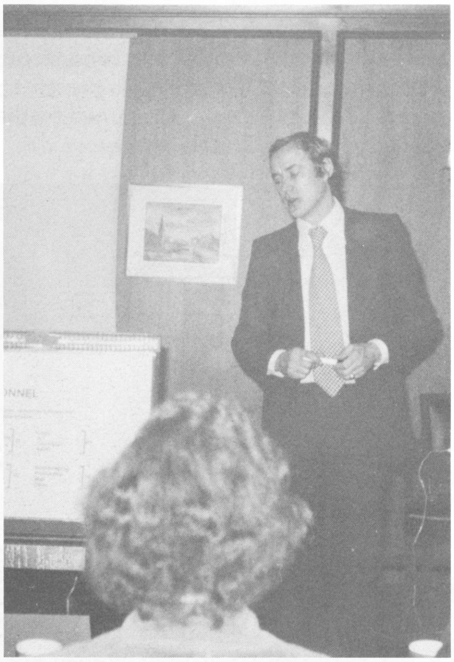
Dresdner Bank. Besides showing us their own facilities, the Dresdner Bank people took us to the Duesseldorf stock exchange and the foreign exchange market which, unfortunately, was closed that day due to France's decision of January 18 to float the franc. Although the Duesseldorf stock exchange is much smaller than either the New York or London exchanges, the full impact of the noise — because there is no glass wall separating the floor from the spectators' gallery — added an interesting dimension to the total composition of a stock exchange.

It is difficult to give a short account of the many fascinating discussions we had with the people from the Dresdner Bank. Some of our students were most intrigued by the fact that all stock market trading in Germany is done by the banks. Others listened spellbound to the story of how German banks and corporations reconstructed their stockholder and bondholder registers after the collapse of the Third Reich in 1945. And still others were fascinated by the present and future balance of payments implications of the millions of foreigners working in Germany.

Treuarbeit. This, the largest German public accounting firm, is a corporation whose stock is owned entirely by the Bonn government — a fact which caused raised eyebrows among our accounting students. The rest of the eyebrows went up when we found out that the English translation of the company's name is "Faithful Work." It also caused one student to mutter: "There must be some reason why we have Ma Bell, the English have the Old Lady of Threadneedle Street, and the Germans have Faithful Work."

An executive of Treuarbeit explained to us the German Company Act which prescribes in minute detail both the form and content of the financial statements. He had also brought along the commentary to consult if you don't understand the law and the commentary to consult if you don't understand the commentary. After that we got into a lively discussion of generally accepted accounting principles versus accounting principles codified in a Company Act and demonstrated that accountants, too, view with scepticism any idea that was "not invented here."

McKinsey & Co. We heard a fascinating talk about financial model building. One very complicated, though highly simplified, model was set up to determine which of three companies (a parent and two subsidiaries) should borrow money given the existing interest rates, corporate income tax rates, government restrictions on money movements, floating exchange rates, and taxes on inter-company interest payments. We decided that only a computer could solve that kind of problem.



Mr. Van Haren Noman reviews operations of Young & Rubicam.

Philips Evoluon in Eindhoven, Holland.

Conclusion

Aside from the interesting facts and ideas enumerated above, we also got answers to questions which are, strictly speaking, not related to the course content. For instance:

Who is the most frigid woman in England? The Old Lady of Threadneedle Street, because she lives in an imposing building with marble walls three feet thick and no heat in January.

How much can a cup of hot tea raise the body's temperature? More than the central heating of a London hotel which is short on oil.

What happens when the hot water faucet in the same London hotel spouts only icy cold water? Water consumption goes down, deodorant consumption goes up.

Why should you visit Gillette when you are in England during the energy crisis? Because you get a free sample of deodorant.

How fast can the Continental Illinois Bank building in London be vacated in case of a bomb scare? Pretty damn fast.

How can American Express change dollars for British pounds without electricity? By candle light.

What does the band play for the changing of the guard at Buckingham Palace? The Stars and Stripes Forever.

How many people were in the Brussels airport at 1:18 p.m. on Sunday, January 13, 1974? 5 immigration officials, 10 customs inspectors, 100 soldiers with submachine guns — and 23 totally intimidated Americans.

How many ways are there of cooking mussles in Brussels? At least 60.

How long does it take to ask a Belgian streetcar conductor in high school French whether one is going in the right direction? Two stops in the wrong direction.

What happens when Touche Ross invites you for a simple buffet luncheon? If it's Monday, you gain five pounds.

How wide is a chartered Belgian bus? Wider than a canal street in Amsterdam.

What is the question most frequently asked by students on this trip? Can I write my paper on the marketing strategies used in the Red Light District of Amsterdam?

What is the answer to the question most frequently asked by students on this trip? No.

What happens when you start the day with freshly-brewed Heineken beer? You continue at the nearest bar until London fog descends on Amsterdam and hides the awful hangover.

What is a semi metro? A Belgian Strassenbahn.

What is a Strassenbahn? A German streetcar.

What happens when a German discussion leader thinks his English isn't good enough for a technical session? You're damn glad you've got a professor along who thinks her German is good enough to act as an interpreter.

What happens if she makes a mistake? Who's gonna know the difference?

How does it feel to walk through foreign cities followed by twenty-one students walking single file? Ask the Pied Piper of Hamelin.

And what happens if you don't change your dollars today? The rate goes down.

Two attentive students at Touche Ross & Co.

And, finally, what happens when you offer an experimental course in International Business and it turns out to be an unqualified success? You prepare a course proposal (in zillions of copies), get it approved by all the right committees (zillions of them), and then offer the trip as a regular course for students. And if all goes well, you make it available for women accountants whose appetite got whetted by this description.

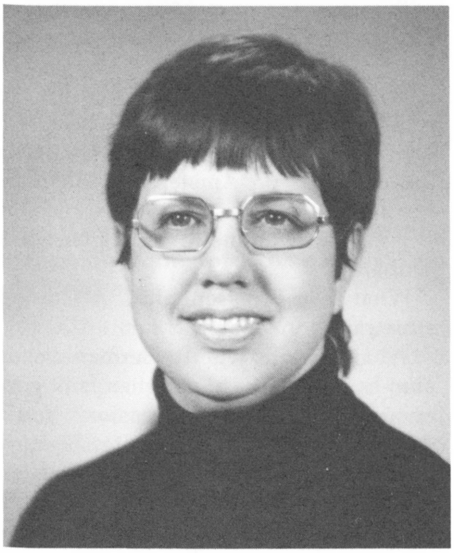
The pictures accompanying this article were taken by Paul Frucci and Wayne Woodruff, students participating in the course.

Lunch at Ford of Europe.

The Attack On The Dollar Concept

Dr. Carole B. Cheatham, CPA
State College, Mississippi

The author explains the shortcomings of the traditional dollar comcept and suggests a new, expanded concept in its place.



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Her professional memberships include the American Institute of Certified Public Accountants, the American Accounting Association, and the National Association of Accountants. She serves as Educational Projects Director for the Northeast Mississippi Chapter of the NAA. She is also a faculty counselor with the Small Business Institute, a program in which senior business administration students provide assistance to small business through the Small Business Administration.

Dr. Cheatham is the author of an article entitled "Is the Polygraph a Valid Internal Control Device?" which appeared in the January-February 1974 issue of the Internal Auditor.

Lists of accounting concepts (or principles) usually include a reference to the dollar concept, the idea that accounting records are kept in the form of dollars. Sometimes the concept is referred to as the money concept, sometimes as the unit of measurement assumption and sometimes the stable dollar convention. Various other terms are also used.

The dollar concept, while continuing to be listed with basic concepts such as continuity, realization, and matching, is under attack from many sources. It is evident that accounting concepts or principles are not the same type of immutable principles found in the physical sciences, nor are they comparable to the axioms or postulates of mathematics. In a social science, such as accounting, principles may change from time to time, particularly when tested by the realities of the business world. The dollar concept may, of necessity, fall by the wayside as the times warrant. It is overwhelming to think that a complex modern business can be reduced to a model stated in dollar terms and contained in three or four pages of financial statements. As accountants face increasingly complicated business systems, the dollar concept must be expanded to include other forms of measurement.

The attack on the dollar concept is currently appearing in three forms: (1) the price level problem, (2) the need to measure human values which are not easily quantified, and (3) the disclosure crisis. The purpose of this article is to examine each of these areas and to propose a broader, expanded version of the dollar concept to encompass the changes needed in today's world.

The Price Level Problem.

This particular attack on the dollar concept is well known, and its inclusion in a discussion of this nature will be no surprise. Most textbook authors who include a reference to the dollar concept also point out that the purchasing power of the dollar is constantly changing. For example, Niswonger and Fess say:

> The dollar is far inferior, as a unit of measurement, to such quantitative standards as the pound, gallon, or yard, which have remained unchanged for centuries. The instability of the purchasing power of the dollar is well known. The disruptive effects of inflation on accounting reports during the past few decades are acknowledged by accountants, but to date recognition has not been given in the accounts and in the conventional financial statements to the declining value of the unit of measurement.[1]

The price level problem is really a dual problem because there are not only changes in the general price level but also changes in specific asset price levels which may move with, or even counter to, the changes in the general price level. Thus, there are changes in the measuring stick (the dollar) reflected in the change in the general price level and also changes in replacement values of particular assets measured by the changes in specific price levels.

Accounting Research Study No. 6 discussed in detail the price level problem as have many other studies. To date, however, price-level adjusted data are merely recommended supplementary material rather than material incorporated into audited financial statements. Adjustments to statements for changes in the general price level appear to have more chance of gaining acceptance by the profession than adjustments for changes in specific price levels. Although the computations may be laborious, the use of a widely-accepted price index provides an objective measure of the change and no radical departure from historical cost. Adjustments for changes in specific price levels involve use of less reliable specific price indexes or appraisals. In this case the departure from historical cost may be significant.

A problem somewhat similar to the price level dilemma is encountered by companies with foreign branches or subsidiaries. The financial records of the foreign segment are usually expressed in terms of the monetary unit of the country in which the branch or subsidiary is located. To prepare financial statements for the company as a whole, it is necessary to translate the account balances to dollars. Depending on the nature of the account, the exchange rate used for the translation may be an historical exchange rate, a current exchange rate, or an average exchange rate for the period. Exchange adjustment gains and losses may result from the translation process. Devaluations during the period of either the domestic or foreign currency present special problems. The dollars of the resulting combined financial statements by no means represent common size or stable monetary units.

The price level problem, as well as the difficulties arising from international operations, have been dealt with at length by other authors, and only a brief discussion is included here. The other two attacks on the dollar concept are perhaps not quite as familiar and will be discussed in greater detail.

Need to Measure Human Values

Accounting has long been thought of as pertaining only to business or at least only to financial data. Today it is becoming recognized that the skills of accountants in dealing with quantifiable variables can be applied to social areas as well as financial areas. Recent issues of accounting periodicals have contained many articles on "social accounting" or "socioeconomic accounting," i.e., the application of accounting techniques to the social sciences. It is easy to see from the current literature that accounting has expanded out of the dollar measurement realm into a broader realm of social measurement. The measurement tools vary from project to project, but it is clear that the tools used do involve more than monetary measures.

One example of accounting's involvement in social measurement was a project undertaken some time ago by Touche Ross & Co. The accounting firm's assignment was to develop an information and management system for the city's various War on Poverty programs. The basic objectives of the assignment were to develop a system for keeping track of individual clients and services rendered and, as a long-range goal, the development of a total management system.

The accounting firm tackled the problem of quantifying characteristics relating to the program by placing the characteristics on a numerical scale. For example, health was placed on a seven-point scale from "excellent" to "failing health to continuous hospitalization." The clients' need was measured by the difference between their current ratings and an acceptable level.[2]

In addition to numerical scales, another tool that has been used to measure human or social values is the cost-benefit ratio. Cost-benefit analysis involves choosing from among alternatives on the basis of costs and their effectiveness in the attainment of specified objectives. Costs are stated in dollar terms, but benefits may be measured in a number of different units. The crucial measure is the ratio of cost to benefits. Variations of the cost-benefit idea include cost-effectiveness analysis, cost-utility analysis, and input-output analysis. Systems analysis and planning, programming, and budgeting systems (PPBS) also use this basic idea.

Utilizing the cost-benefit concept, David Linowes gives an example of a program designed to keep high school students from "dropping out." The cost is dollars used in maintaining a school and faculty, and the benefit is the number of students who stay in school until graduation.[3]

Cost-benefit analysis was also used by Price Waterhouse when it assisted the Philadelphia school district in setting up a program budget. Rather than the old-line approach of making the budget a departmental responsibility, the budget is expressed in terms of inputs and outputs. In an elementary school, inputs are numbers of teaching aids or dollars of cost. Outputs are boosted reading or arithmetic skills.[4]

Two tools used to measure human or social values are numerical scales and ratios of costs and benefits. Accountants are increasingly being employed to measure such values. In measuring such values, they are departing from the dollar concept.

The Disclosure Crisis

Another attack on the dollar concept is caused by the need to disclose information to the readers of financial statements which cannot be expressed in dollar terms. Financial statements of larger companies today usually contain two or three pages of footnotes in fine print. Some information contained in footnotes is more important than that which appears in the body of the reports. As time goes on, even more information may have to be attached to the financial statements to make them meaningful.

It is almost impossible to compile an exhaustive list of items which cannot be disclosed by the dollar amounts in financial statements and must be disclosed parenthetically or by footnote. The following items are examples of commonly disclosed items:

1. Essential provisions of employee pension or retirement plans.
2. Stock option plan information.
3. Description of leases and accounting methods used for leasing activities.
4. Past balance sheet events which have a material effect on the financial statements.
5. Contingent events which may have a material effect on the financial statements.
6. Effect of changes in accounting principles, reporting entries, estimates that affect future periods, or correction of material errors.

In addition to items such as those appearing on the above list, it is necessary to disclose departures from Opinions of the Accounting Principles Board even though substantial authoritative support exists for the method used.

The disclosure principle has been stated as "Accounting reports should disclose that which is necessary to make them not misleading."[5] It is easy to see that this is a catch-all provision and many items that occur in special situations may be disclosed at the discretion of the accountant. In fact, many accountants have applied the rule "when in doubt, disclose" which multiplies the amount of fine print in an annual report.

There seems to be every reason to believe that accountants will disclose more nonmonetary material concerning the financial statements, rather than less, as time goes on. In the Continental Vending decision in 1969, Judge Friendly wrote in his opinion that accountants must do more than merely comply with generally accepted accounting principles; they must make whatever disclosures are necessary for fair presentation of the data.[6] Other lawsuits have also questioned the accounting methods and disclosure practices of accounting firms. Almost every Big Eight firm has had to defend itself in at least one suit of this kind. Thus, accountants seem to be faced with more thorough disclosures even though they themselves may not desire such a move.

The disclosure problem is recognized by the business community. Some time ago *Business Week* published an article entitled "Accounting: A Crisis Over Fuller Disclosure." In this article, the writer commented:

> The problem is complicated by the enormous complexity of modern business. Companies can operate in a dozen different countries and two dozen different industries. To reduce such complex operations to a simple balance sheet and consolidated income statement — even with supporting tables and pages of detailed footnotes — call for sweeping simplification . . . the fair disclosure doctrine has thrown the accounting profession into a state of confusion, confrontation, and crisis. Accounting is not a precise body of rules covering every case that comes up . . . Inevitably it contains a large component of personal judgment.[7]

The need to disclose nonmonetary information presents an attack on the dollar concept. Not all essential data, even in financial reports, can be expressed in dollar terms. Disclosures attached to current statements in footnote or parenthetical form are usually lengthy. The need to disclose even more data demanded by the courts and the business community will cause such additional information to continue to be lengthy and probably to increase in the future.

Towards a Better Concept

The dollar concept is outdated in terms of what accountants are doing today. The attack has come in three different forms: the effects of the unstable purchasing power of the dollar, the need to measure human values, and the need to disclose information that is not stated in dollar terms. A broader statement on measurement in accounting is needed.

Although the dollar concept is clearly too narrow a concept for what accounting attempts to do, accounting still remains a quantitative skill. Perhaps a better statement of the measurement idea would be: "Quantification: Accounting quantifies financial and other information." Such a statement makes clear the idea that accounting does quantify data but does not limit the unit of measurement to dollars, ratios, units of production, number of shares of stock, or whatever. The statement emphasizes that financial information is the primary type of data with which accounts deal (although this may change at some future date) but does not exclude other types of information, such as social values.

It may be argued that such a statement is too broad and could apply to many of the quantitative sciences such as mathematics or statistics. It is not necessary that an accounting concept or principle be a limiting assumption. A concept or principle does not try to define accounting or state its limits, it merely lists one of the things that accounting tries to do. Disclosure or continuity are concepts that could easily be applied to areas other than accounting.

It could also be argued that such a quantification statement is too narrow, that — particularly in the disclosure area — accounting is not even attempting to quantify some variables. This argument appears to have some validity. Perhaps one way to correct such an omission is to tackle the problem from the standpoint of restating the disclosure concept, although such a restatement is outside the realm of this article. Another way to approach the problem is to explain the basic concept, "Quantification: Accounting quantifies financial and other information," by adding something like "however, descriptive material may appear in nonquantitative terms." It would seem that the basic statement is sufficient as it stands but some additional clarification could be made, if desired. It has always been recognized that accounting contains descriptive information concerning dollar amounts. Dollar amounts are meaningful only when explained by account titles, balance sheet and income statement classification, etc. Any type of quantitative data can be expected to have some descriptive titles and information.

Summary

An accepted concept in accounting is the dollar concept, the idea that the unit of measurement in accounting is the dollar. In today's world the dollar concept has become outmoded. Fluctuating price levels cause the dollar to be an unstable measuring stick. Moreover, accounting is becoming increasingly involved in measuring human values which cannot be expressed in dollar terms. Even financial information is difficult to present in strictly dollar amounts because the courts and the accounting profession demand more and more thorough disclosure of pertinent data.

What is needed is a restatement of the dollar concept. A suggested restatement is: "Quantification: Accounting quantifies financial and other information." Broadening the dollar idea to a general quantification concept allows the concept to encompass the changes in the scope of accounting that have occurred.

Footnotes

[1]C. Rollin Niswonger and Philip E. Fess, *Accounting Principles*, 10th ed. (South-Western Publishing Co., 1969) p. 349.

[2]Robert Beyer, "The Modern Management Approach to a Program of Social Improvement," *Journal of Accountancy*, CXXVII, No. 3, (March 1969), pp. 37-45.

[3]David F. Linowes, "Socio-Economic Accounting," *Journal of Accountancy*, CXXVI, No. 5, (November, 1968), p. 40.

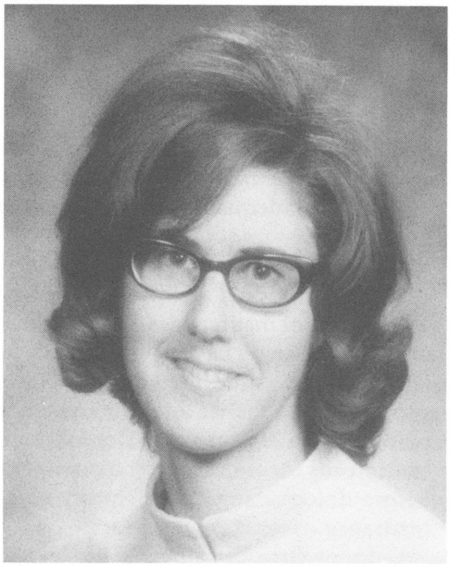
[4]Donald Rappaport, "New Approaches in Public Education," *Journal of Accountancy*, CXXVI, No. 1 (July 1968), p. 36.

[5]Maurice Moonitz, "The Basic Postulates of Accounting," *Accounting Research Study No. 1*, AICPA (New York 1961), p. 50.

[6]*U.S. v. Carl J. Simon, et al.*, 425 F 2d 796 (1969).

[7]"Accounting: A Crisis Over Fuller Disclosure," *Business Week*, No. 2225, (April 22, 1972), p. 55.

Planning for Personal Financial Security



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The author suggests ways in which accountants can help their clients analyze and plan their personal finances.

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The value of budgets, cash-flow statements, and projections for businesses is generally acknowledged. Similar information for individuals could also be useful, but it is seldom seen. Recently, however, increasing attention has been given to the subject of personal finance. Statistics, for instance, indicate:

1. A national survey has shown that money problems were cited in 9 out of 10 cases as the major cause of divorce.[1]
2. U.S. 1972 GNP was $1,155 billion. This included $54 billion spent on residential structures and $727 billion spent on personal consumption.[2]

Obviously, what consumers choose to do with their money is of primary importance to the economy, and many recent discussions on the subject of inflation have stressed this.

With such facts accountants can expect that people will increasingly turn to them for assistance with personal financial planning. If they are to accept the responsibility of giving such advice, they should think about and discuss ways of applying accounting skills to this area. This article suggests one possible approach by discussing some ideas in each of the following areas:

1. Budgeting and Recordkeeping
2. Organizing the Information into a Useful Format
3. Analyzing the Information

Budgeting and Recordkeeping

If an individual asks for assistance with personal financial planning, the first thing to do is to set up a budget and a system for recording receipts and expenditures. The mechanics of developing a personal budget and keeping personal records will not be covered here, because there are any number of good books on the subject.

By developing a step-by-step guide of one or two pages in a form that will encourage the client to do as much as possible on his or her own, the amount of time needed for this aspect can be minimized. The client should be aware that the budget developed will be of little value if no records are kept showing variances from the budget. It is *not* necessary to have a record of every penny spent, however. The client needs a reasonably accurate picture of receipts and expenditures, not a set of books that can be audited by the IRS. It must be remembered that the client is probably not a bookkeeper and does not intend to become one. For that reason any recordkeeping should be made as simple as possible. There are many inexpensive books on the market that would serve the purpose. The local variety store should have several from which to choose.

Once the budget is set and recordkeeping is under way, a date should be selected for an annual review. This does not have to be December 31, April 30 may do just as well. At that point the shock of income taxes will probably still have the client in the mood for financial planning. On the other hand, a client may prefer a fall date. In that case it may be possible to combine this work with some year-end tax planning.

Whatever date is selected, the next task is to obtain a list of assets and liabilities as of that date. The client should be able to furnish such a list, but the job can be simplified by providing an inventory sheet.

Included should be information on whether property is jointly owned and, if so, with whom; the original cost of assets (estimated, if necessary); and the remaining balances of all liabilities. The inventory schedule should also request information regarding the cash surrender value and face value of life insurance policies, the value of vested interests in pension or profit-sharing plans (it may be necessary to dig up this information), and sufficient information about investments to determine current market values. If the client has business interests, they have to be valued, probably by the accountant. In addition to the inventory of assets and liabilities, the accountant needs the client's record of receipts and expenditures for the annual review.

Organizing the Information Into a Useful Format

Perhaps the most useful formats for accountants are the familiar ones, e.g., a statement of assets, liabilities, and excess of assets over liabilities and a statement of receipts and expenditures. A word of caution: this discussion is based upon the premise that the information is assembled either for use in the accountant's workpapers or as a basis for developing a form that the client will complete.

If the accountant provides financial statements for the client, he or she should be familiar with the discussion of personal financial statements found in the American Institute's *Audit Case Study of Personal Financial Statements.*[3] Briefly, this study requires that the individual(s) reported upon be clearly identified in the statements, that statements be prepared on the accrual basis, and that assets be shown at cost. A parallel column showing estimated values can be included. The assets and liabilities should be listed in order of liquidity with no separation of current and non-current items. Disclosures of any pertinent information, including basis for estimating current values, should be included. Even if audited financial statements are not prepared, it may be wise to follow these guidelines. Caution should be used in preparing any information for release that in any way resembles financial statements, as that information could easily become part of a loan application at the local bank or credit agency.

Analyzing the Information

Having organized the data into the traditional statements or a similar format, the accountant is now ready to analyze them. What are some of the points to consider when reviewing financial security?

The first consideration may be the cash situation. It is generally recommended that people have an emergency fund of three to six months' take-home pay. Some individuals may choose to ignore this guideline preferring to risk a forced sale of assets. The person who cannot afford to sell assets in an unfavorable market, however, should be concerned with establishing an emergency fund that will provide for a period of unemployment, illness, major repairs, etc. The extent of insurance coverage will, of course, affect the size of the emergency fund needed. With substantial insurance coverage, eligibility for unemployment compensation, and little likelihood of a strike, an emergency fund equal to three months' take-home pay may well be adequate. For those with little insurance, frequent illnesses, etc., a larger reserve should be considered.

Is the individual adequately insured? The subject of insurance is a controversial one. Many people have opinions on what is best, but it is not the accountant's responsibility to choose for the client, but to point out the alternatives. The following basic needs for cash should be considered before determining the adequacy of life insurance coverage:

1. Immediate cash needs for last expenses: at least $2,000.
2. Living expenses during a period of adjustment: six months' to a year's income.
3. An emergency fund for an unexpected crisis: between $1,000 and $3,000 depending on the size and the health of the family.
4. An income fund if the surviving spouse will be unable to work: one estimate is to use ½ of the former income, but not less than $500 per month if there are children still in school; if no children, ¼ of the former income, but not less than $350 per month.
5. Debt repayment fund: included should be major debts that could not be repaid if income is reduced (see number 4, above).
6. College education fund.

The total insurance required could, of course, be reduced if the family has assets that it could, and would want to, convert to cash if needed. Without debating the advantages of permanent versus term insurance, the client should be aware of the possibility of term insurance in cases where the need for insurance is temporary or he or she is grossly under-insured and does not have the money for premiums on permanent insurance.

While considering insurance coverage, a review of the current value of the client's assets may reveal that household or other insurance coverage has not kept pace with changing values.

How much debt can a person handle? The best way to answer this question is to review receipts and expenditures and discuss areas in which present spending can be cut. It should then be possible to determine the amount of money available to meet monthly payments. This approach would apply to any debts, from small installment loans to a home mortgage.

An essential part of planning for financial security is planning for retirement. It is usually recommended that an individual plan for a retirement income of 50 to 60% of the final working salary. In the present era of high inflation, this becomes more complicated and more important. A starting point might be an evaluation of potential retirement income in terms of any vested interest the client has in pension or profit-sharing plans and in social security, and to determine the value and growth rate of the investments. It must not only be determined whether the 50 to 60% requirement is met now, but also whether the retirement funds are growing at least as fast as the economy.

Social security currently provides a retirement income equal to, at a minimum, about 40% (60% if spouse also collects) of a worker's average monthly wage subject to social security. This does not mean that social security can provide all the retirement income needed, however, for two reasons: First, wages may exceed the maximum wage on which social security is collected (and on which payments are based). Second, the maximum wage on which social security is paid has been changing rapidly and the client's social security benefits will be based on average earnings subject to social security. The client should aim toward additional retirement income equal to at least 50% of earnings in excess of average social security credited earnings.[4] Unless he or she has only recently started to work, this amount is apt to be less than $6,000 to $7,000 a year.

A corporate pension plan integrated with social security may provide the additional funds required. If this is the case, the accountant should obtain a copy of the explanation of the plan prepared for employees and determine how the pension will be computed and what the vesting requirements are. If the client is covered by a money-purchase pension plan or a profit-sharing plan, it may be possible to determine the average annual contribution to the plan and to evaluate the growth rate of investments in the plan. Again, vesting requirements should be determined before counting on this source of retirement income.

If the client is self-employed, a tax-deferred Keogh plan should be considered. Under this plan contributions can be deferred, within limits, until after retirement when tax rates are apt to be lower. Earnings on funds within the plan also escape current taxes. These advantages must be weighed, however, against the facts that employees may have to be included in the plan, that there are limitations regarding the types of investment, and that the funds cannot be touched in case of emergency. If the client is considering a Keogh plan, the accountant should prepare a schedule showing the estimated long-range financial consequences. The client will then have to decide whether the financial benefits outweigh the limitations on flexibility.

The client may decide to pursue a personal investment program along with, or instead of, a pension or profit-sharing plan. He or she may follow a basically conservative or a speculative approach. Whatever the approach, however, if it has not proven successful by twenty years prior to the intended retirement, it is time to do some serious re-evaluating. One method of estimating the amount that the client should be investing in a retirement fund annually is shown in Schedule 1. The computation is based on the assumption that the investments will grow at the same average annual rate as the economy. The following assumptions, which can be changed to fit different situations, have also been made:

1. 1972 earnings were $13,000 and the individual has earned at least the maximum for social security purposes since 1951.

2. The individual is now age 45, with no pension or profit-sharing plan other than social security, wishes to retire at age 65, and expects to live 20 years beyond retirement.

3. Investments will earn 6% before taxes.

4. The individual's tax bracket during working years is approximately 25% and is expected to be negligible after retirement.

In this particular case the individual would need to put approximately 18% of earnings in excess of average social security credited earnings into investments that would compound at a current rate of 6% before taxes and that would continue to grow as fast as the economy. This would need to be done each year between now and retirement. If he or she should wait for another five years before starting the retirement plan, it would be necessary to put about 28% of the excess into the same type of investment. The longer this is put off, the more impossible the task becomes. These percentages would vary as different assumptions and estimates are used, but twenty years prior to retirement is generally none too soon to think seriously about retirement finances.

Schedule 1

	Age 45	Age 50
Earnings	13,000	13,000
Less average social security credited earnings	5,800	5,800
Excess	7,200	7,200
Minimum additional needed per year of retirement — 50% of excess	3,600	3,600
Multiplied by the factor for the present value of an annuity for 20 years assuming 6% earnings after taxes	×11.470	×11.470
Amount required at retirement	41,292	41,292
Divided by the factor for the amount of an annuity for 20 (15) years assuming 4½% earnings after taxes	÷31.371	÷20.784
Annual investment required	1,316	1,986
Annual investment as a percent of the excess earnings	18.3%	27.6%

Summary

Accountants can expect to receive more and more requests for assistance with personal financial planning. They can be most effective by developing step-by-step guides for individuals to follow as they collect and summarize personal financial information. These guides should be designed to encourage clients to do as much as possible on their own. The accountants' efforts can then be concentrated in the areas that most require their professional skills and justify their fees: those of helping individuals to analyze and interpret the financial data they have gathered and to understand the relationship of financial security needs to their total financial picture.

Footnotes

[1]Books by U.S. News & World Report, *Planning Your Financial Future,* (Washington, D.C., U.S. News & World Report, Inc., 1972)

[2]From revised statistics reported in July, 1973, *Survey of Current Business* published by the U.S. Department of Commerce.

[3]American Institute of Certified Public Accountants, *Audits of Personal Financial Statements,* (New York, American Institute of Certified Public Accountants, 1968)

[4]To determine average social security credited earnings, add earnings since 1951 up to the maximum each year. Exclude the five lowest years. Divide by the number of years for which wages were included. Maximum covered earnings since 1951 were:

1951-1954	$3,00,600
1955-1958	4,200
1959-1965	4,800
1966-1967	6,600
1968-1971	7,800
1972	9,000
1973	10,800

Electronic Data Processing

The Importance of System Standards

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Standards are the procedures and rules under which the analysts, programmers, operators, and users of a data processing system operate. Standards can provide a dual benefit to an installation. First, they can act as a guideline by which uniform practices and common techniques are established. Secondly, they can be used as a criteria by which the performance of the various computer services functions can be measured and subsequently evaluated. If the standards are carefully and thoughtfully established they can help improve the productivity of installation activities by selecting the most efficient procedures for a given installation from a variety of possible alternatives and by providing some formal control of the application development process and subsequent use of that application design.

Functions and Activities Conducive to the Development of Standards

There are a number of areas which lend themselves to the development of standards — either within an installation or within the data processing industry as a whole. Some of these are the need to develop standards for use of the hardware itself. An example is the limitation currently imposed by some OCR (Optical Character Reader) facilities to particular character or type styles. If printed material is consistently produced in one of these type styles and new equipment (typewriters, etc.,) is selected to conform, installations will be able to increase the use of source documents directly as input. Another area of hardware development which would be facilitated by standards is an attempt to settle on hardware specifications in the data communications area which will facilitate greater interchangeability between terminal devices and transmission facilities of the common carriers.

The industry as a whole has seen the development of common programming languages which provide a degree of source compatibility between hardware configurations of various vendors. Languages as FORTRAN, ALGOL, COBOL have had a very strong influence in promoting the use of source-compatible languages which to a great extent frees the programmer from the immediate concerns of programming for a particular hardware system and allows concentration on the logical aspects of the problem.

Within an installation, programming languages can also be the subject of installation standards as the installation settles on languages acceptable to that installation and the particular features of that language which will be implemented. Frequently, these language systems provide a wide choice of alternative processing techniques and most installations find that they need only a part of all available options. By establishing a standard list of the language options that will be used in the installation, installation systems support for the language can be streamlined and program development, review, control, and maintenance can be simplified.

The same kind of choices are available in the general systems programming support provided by vendors. For example, in IBM's operating system a large number of data access methods are provided — many more, in fact, than any given installation is likely to need. Based upon the information handling requirements of the installation, many installations will choose a subset of the total access methods available which will be implemented in that installation. Once these standards are established, programmers and systems designers are required to plan their applications around these access methods. This has the benefit of reducing the complexity of the operating system and shortening the design time by eliminating the need for designers to investigate all potential access methods for each installation.

Of course, these standards should be periodically reviewed and changed when the needs of the installation change. The improved program library facilities and compiler capabilities have greatly increased both the opportunities for use of standard subroutines and modular programs and the efficiency with which these techniques can be implemented. An installation can improve its ability to use these techniques by developing installation standards for inter-program communication, program identification, and file identification. Operating standards are also important to an installation. The establishment of specific procedures to be followed for various conditions again insures that operations will be performed in a reliable and predictable way.

An area in which a great deal of work has been done in the development of standards is the area of systems and program documentation. If one of the major advantages of documentation is its ability to allow others to understand the system and program, it must be able to communicate effectively. The use of symbols and techniques which are well known to the reader enhances that communication ability. Consequently, there has been a trend toward the establishment of standard symbols and flowcharting techniques to facilitate this kind of communication.

Within an individual installation, the decision can be made to use a standard form of documentation and, for purposes of installation standards, to specify exactly which kinds of documentation will exist. Thus, it could be expected that an installation will have a "standard documentation package" in which is specified the various elements which are to be provided, such as a narrative description, a systems flowchart, program flowchart, specified record layouts, the specified operating instructions, et cetera. Then, all units of the installation will know exactly which information will be available in the documentation package.

Installation standards can be developed in a variety of ways. Some come as a result of external circumstances. There are certain de facto standards which have developed as a result of dominance by either a particular vendor or a professional group. IBM, which has long represented a major influence in the computer industry, has been responsible for the introduction or popularization of several standard data processing forms — the 80-column card being one example. The development of standard internal code formats for magnetic tape and paper would facilitate transfer of data directly from one machine system to another. Further, the selection of a particular language or operating system provided by a vendor also provides a limitation on the choice available within an installation. The development of certain recommended procedures or techniques by professional organizations, such as the American National Standards Institute (ANSI), will also influence the work within an installation.

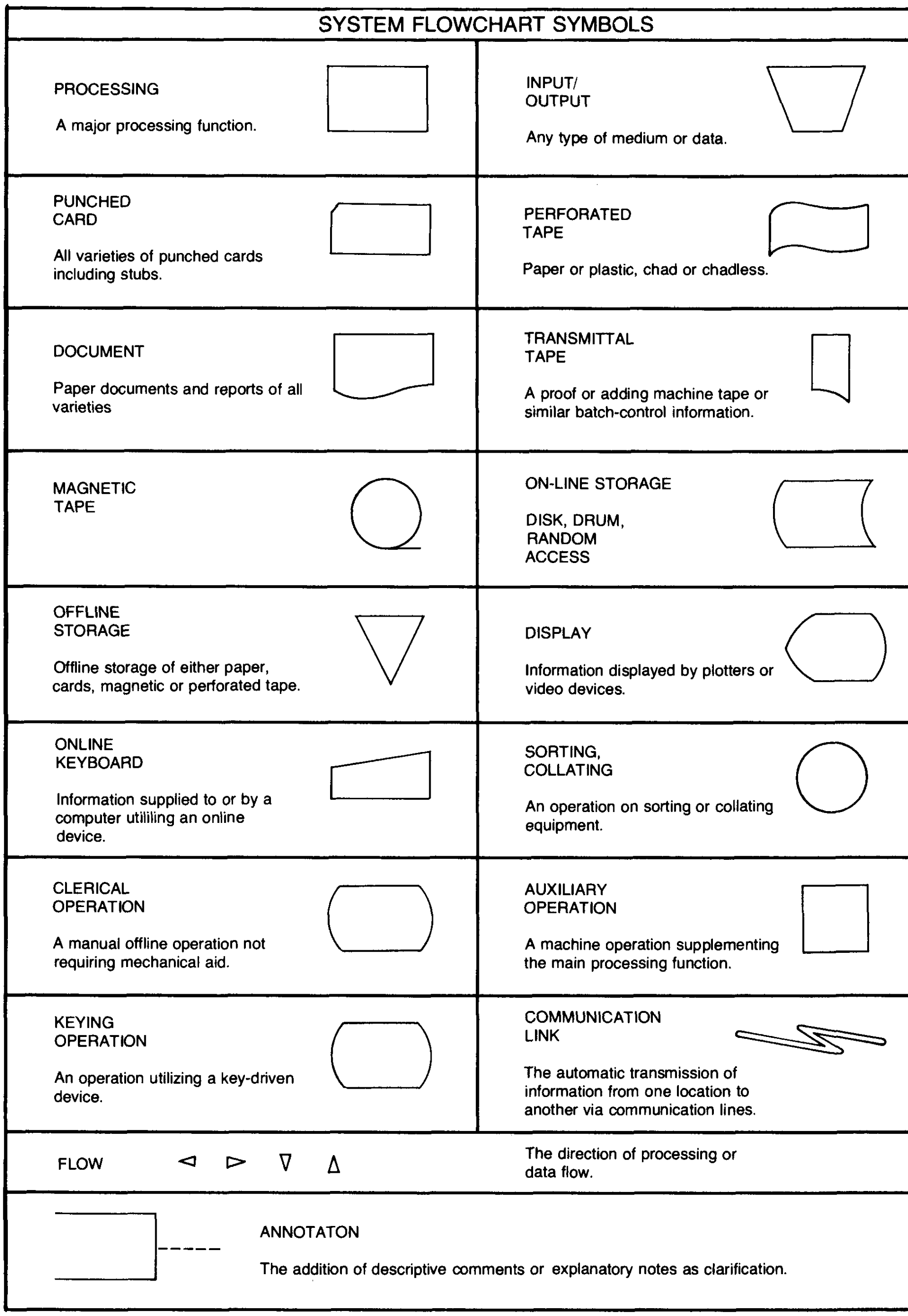

Figure 1.a – ANSI Symbols for Systems Flowcharts

Work of the American National Standards Institute

ANSI is a private, voluntary organization or federation of approximately 150 trade associations and professional societies and many companies interested in developing standards. It acts as a national clearing house and coordinating agency for voluntary standardization and approves a standard only if it is supported by a consensus of all the national groups substantially concerned with the scope and provisions of that standard. It participates in the International Organization for Standards (ISO), the International Electrotechnical Commission (IEC), and in the Pan American Standards Committee (PASC).

ANSI has a number of committees assigned to various areas. The committee assigned to computers and information processing is Committee X3. Committee X3 is composed of representatives of a number of producers, a number of users, and a general interest group consisting of the professional societies. Among the professional societies involved are Administrative Management Society, American Institute of Certified Public Accountants, American Society of Mechanical Engineers, Association for Computing Machinery, Association for Educational Data Systems, Data Processing Management Association, Electronic Industries Association, International Communications Association, Institute of Electrical and Electronic Engineers, Joint Users Group, National Bureau of Standards, Systems and Procedures Association. Committee X3 is organized to consider a number of areas. These are: optical character recognition, input-output standardization, data communication, common programming languages, terminology, problem definition and analysis, and data elements and coded representation.

One standard adopted by ANSI is that of flowchart symbols. Figure 1 illustrates the standard symbols which have been adopted. The benefit of using symbols specified by a national organization such as ANSI is that an installation is saved the necessity of developing its own standards. Further, as the installation hires new programmers who are already familiar with the national standards, the orientation towards installation standards can be lessened if the installation standards are compatible with industry-wide standards.

Development of Installation Standards

In addition to adopting those techniques recommended by national groups or provided as a by-product of the vendor software or hardware selected, an installation should also develop certain standards which will be unique to that installation. In a larger organization, a formal standards committee should be formed. This committee should consist of representatives from user groups as well as the data processing group. It should include representatives from the systems design function, the programming function, the operations function, the control function. This diverse representation will help insure that the needs of all segments of the organization are considered when a standard is developed.

Standards developed by a consensus of the users of information so affected will usually be more effective and useful than those dictated by one individual or a very small group. In addition to determining which languages will be used and which access methods an installation will use, the standards within an installation or company can also concern themselves with the definition of standard data elements, file structures, file labeling procedures, procedures for the design and approval of application development.

Another area which the installation can examine is the development of performance and educational standards. If the educational or experience requirements for each type of activity can be defined by the installation, the process of recruitment can be simplified. Further, this can help provide a basis for effective interchange of personnel within divisions and various staff functions, as well as provide the installation with a depth of back-up for key positions, by making it possible to provide for promotion from within the installation when new openings are created.

Wherever possible, the organization should develop performance standards which can be used to indicate how long it should take to perform various operations or tasks. These standards can be developed for a variety of situations and can take into account the complexity of an individual operation as well as the experience level of the individual performing the service. Once an installation establishes satisfactory standards, they can be used as a yardstick to measure the performance of various staff. Further, by establishing standard times for performance of the various tasks studied, performance standards facilitate the planning and scheduling functions.

Benefits of Computer System Standards

Standards provide a means by which an installation can reduce the amount of variation in the implementation of essentially similar functions, and thus promote interchangeability of many of the processing components. Furthermore, it helps facilitate greater efficiency in the development and operational processes, for staff need not spend time choosing among several alternate options if the preferred technique is already defined by the installation.

Organization-wide standards also help promote communication among the various component groups responsible for a

Continued on page 26

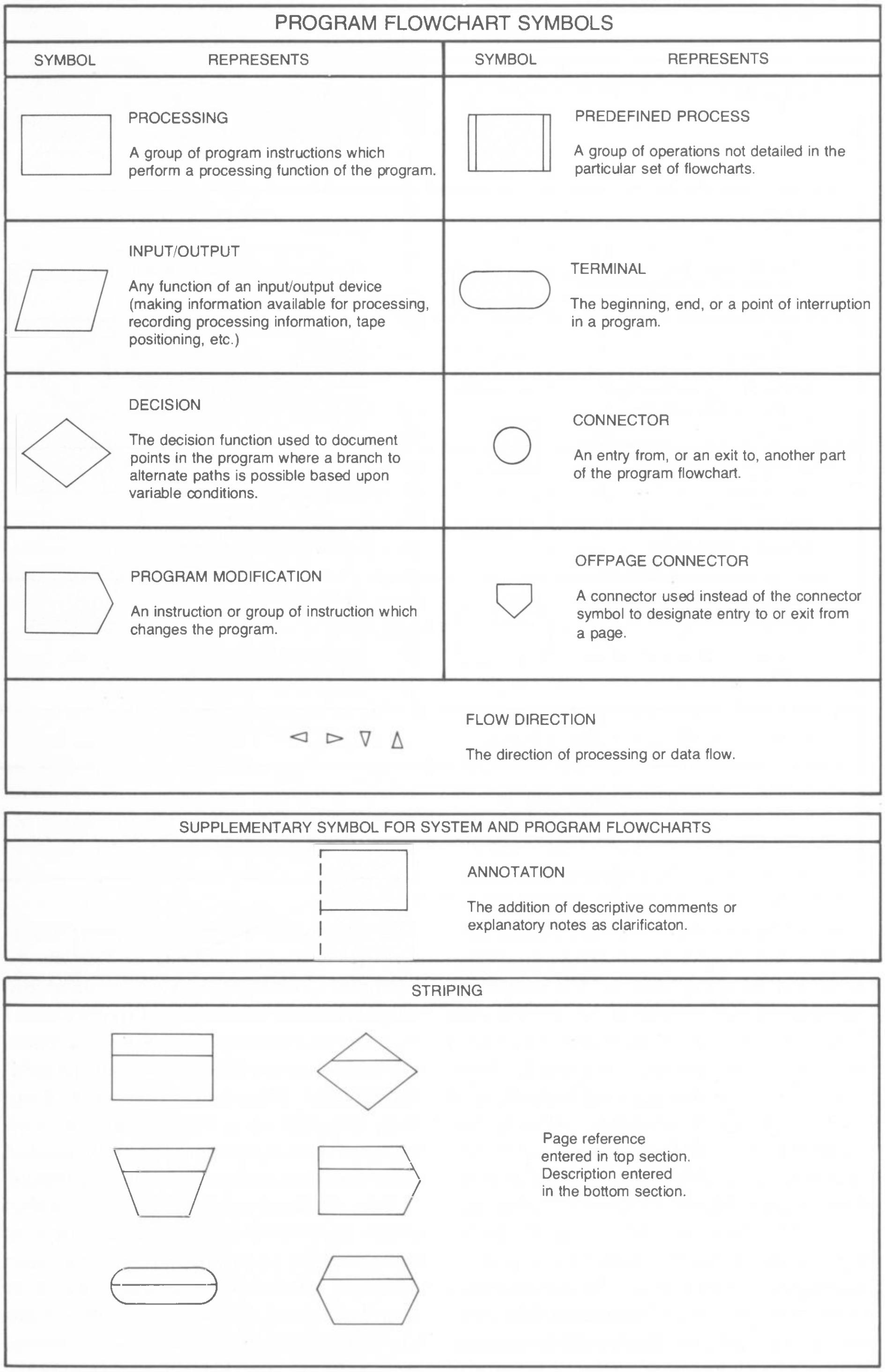

Figure 1.b – ANSI Symbols for Systems Flowcharts

Education

Answers to Multiple Choice Questions on the May 1973 CPA Exam

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In recent years the Uniform CPA Examination has included a number of multiple choice questions. In the unofficial answers published by the AICPA, the correct answer is listed without explanation. With the thought that it would be useful for all who work through the problems, including students studying for the CPA examination, the method of arriving at the answers to one set of multiple choice questions on the May 1973 examination follows:

Examination in Accounting Practice Part I, May 9, 1973 Group I, No. I

1.Goldstein Cereals, Inc., distributes coupons to consumers which may be presented (on or before a stated expiration date) to grocers for discounts on certain cereals. The grocers are reimbursed when they send the coupons to Goldstein. In the Company's experience 30% of such coupons are redeemed, and on the average one month elapses between the date a grocer receives a coupon from the buyer and the date Goldstein receives it. On May 1, 1972, Goldstein issued coupons with a total value of $10,000 and an expiration date to the buyer of December 31, 1972. As of December 31, 1972, Goldstein had disbursed $2,500 to grocers for these coupons. The December 31, 1972, balance sheet should include a liability for unredeemed coupons of

a. $0.
b. $375.
c. $500.
d. $2,250.

Answer: c. $500.

Issued coupons with a total value of	$10,000
30% expected to be redeemed	$3,000
Coupons redeemed as of 12-31-72	2,500
Coupons expected to be redeemed (liability)	$ 500

(Welsch[3], pages 642 and 643)

2. Ecol Corporation issued voting preferred stock with a fair value of $1,000,000 in exchange for all of the outstanding common stock of Ogee Service Company. Ogee has tangible net assets with a book value of $500,000 and a fair value of $600,000. In addition, Ecol Corporation issued stock valued at $100,000 to an investment banker as a "finder's fee" for arranging the combination. As a result of this combination Ecol Corporation should record an increase in net assets of

a. $500,000.
b. $700,000.
c. $600,000.
d. $1,100,000.

Answer: d. $1,100,000.

Fair market value of preferred stock	$1,000,000
"Finders fee" for arranging the combination	100,000
Increase in assets of Ecol Corporation	$1,000,000

(APB Opinion #29 states that the cost of a nonmonetary asset acquired in exchange for another nonmonetary asset is the fair market value of the asset surrendered to obtain it and a gain should be recognized in the exchange.)[1]

3. During 1972 Hoffman Company had a net income of $50,000 (no extraordinary items) and 50,000 shares of common stock and 10,000 shares of preferred stock outstanding. Hoffman declared and paid dividends of $.50 per share to common and $6.00 per share to preferred. Although the preferred stock is convertible into common stock on a share-for-share basis, it is not classified as a common stock equivalent. For 1972 Hoffman Company should report fully diluted earnings (loss) per share of

a. $.83 1/3.
b. $1.00.
c. $(.20).
d. $.50.

Answer: c. (.20)

Net income	$50,000
Preferred stock dividends	−60,000
	$(10,000)

(10,000.) ÷ 50,000 shares = (.20)
(APB #15 requires that fully diluted earnings show maximum potential dilution of current earnings per share on a prospective basis.)[1]

4. On April 15, 1972, a fire destroyed the entire merchandise inventory of John Anderson's retail store. The following data are available:

Sales, January 1 through April 15	$72,000
Inventory, January 1	10,000
Purchases, January 1 through April 15	70,000
Markup on cost	20%

The amount of the loss is estimated to be

a. $24,000.
b. $20,000.
c. $22,400.
d. $8,000.

Answer: b. $20,000.

Inventory, January 1	$10,000
Purchases, Jan. 1 thru April 15	70,000
	$80,000
72,000 ÷ 120%*	−60,000
Inventory April 15	$20,000

*cost + .20 cost = 72,000; therefore cost = $60,000.
(See Welsch[3], pages 378 and 379.)

5. The gross profit of Adelate Company for 1972 is $56,000, cost of goods manufactured is $300,000, the beginning inventories of goods in process and finished goods are $18,000 and $25,000, respectively, and the ending inventories of goods in process and finished goods are $28,000 and $30,000, respectively. The sales of Adelate Company for 1972 must have been

a. $341,000.
b. $346,000.
c. $356,000.
d. $351,000.

Answer: d. $351,000.

Beginning inventory finished goods	$ 25,000
Cost of goods manufactured	300,000
	$325,000
Ending inventory finished goods	−30,000
	$295,000
Gross profit of Adelate Co.	+56,000
Sales	$351,000

6. The business combination of Jax Company — the issuing company — and the Bell Corporation was consummated on March 14, 1973. At the initiation date, Jax held 1,000 shares of Bell. If the combination were accounted for as a pooling of interests, the 1,000 shares of Bell held by Jax would be accounted for as

a. Retired stock.
b. 1,000 shares of treasury stock.
c. (1,000 ÷ the exchange rate) shares of treasury stock.
d. (1,000 x the exchange rate) shares of treasury stock.

Answer: a. retired stock
(see APB Opinion #16)[1]

7. The partnership of Wayne and Ellen was formed on February 28, 1973. At that date the following assets were contributed:

	Wayne	*Ellen*
Cash	$25,000	$ 35,000
Merchandise	—	55,000
Building	—	100,000
Furniture and equipment	15,000	—

The building is subject to a mortgage loan of $30,000, which is to be assumed by the partnership. The partnership agreement provides that Wayne and Ellen share profits or losses 25% and 75%, respectively. Ellen's capital account at February 28, 1973, would be

a. $190,000.
b. $160,000.
c. $172,500.
d. $150,000.

Answer: b. $160,000.

Cash	$ 35,000
Merchandise	55,000
Building (net of mortgage)	70,000
	$160,000

8. Based on the same facts as described in item 7, if the partnership agreement provides that the partners initially should have an equal interest in partnership capital with no contribution of intangible assets, Wayne's capital account at February 28, 1973, would be

a. $100,000.
b. $115,000.
c. $200,000.
d. $230,000.

Answer: a. $100,000.

Cash	$ 25,000
Furniture and fixtures	15,000
Ellen's capital	160,000
	$200,000

200,000 ÷ 2 = $100,000.

9. Jones sold land to Smith for $200,000 cash and a noninterest-bearing note with a face amount of $800,000. The fair value of the land at the date of sale was $900,000. Jones should value the note receivable at

a. $900,000.
b. $800,000.
c. $700,000.
d. $1,000,000.

Answer: c. $700,000.

Fair market value of land	$900,000
Cash received	200,000
Value of the note receivable	$700,000

(See APB Opinion #29)[1]

10. On April 30, 1973, White sold land with a book value of $600,000 to Black for its fair value of $800,000. Black gave White a 12%, $800,000 note secured only by the land. At the date of sale, Black was in a very poor financial position and its continuation as a going concern was very questionable. White should

a. Use the cost recovery method of accounting.
b. Record the note at its discounted value.
c. Record a $200,000 gain on the sale of the land.
d. Fully reserve the note.

Answer: a. Use the cost recovery method of accounting
(APB Opinion #10 states that revenues should ordinarily be accounted for at the time the transaction is completed. If there is no reasonable basis for estimating the degree of collectibility, either the installment basis or cost recovery method of accounting may be used.)

11. On April 1, 1972, Austin Corporation sold equipment costing $1,000,000 with accumulated depreciation of $250,000 to its wholly owned subsidiary, Cooper Company, for $900,000. Austin was depreciating the equipment on the straight-line method over 20 years with no salvage value, which Cooper continued. In consolidation at March 31, 1973, the cost and accumulated depreciation, respectively, are

a. $1,000,000 and $300,000.
b. $900,000 and $50,000.
c. $900,000 and $60,000.
d. $750,000 and $50,000.

Answer: a. $1,000,000 and 300,000
1,000,000 ÷ 20 = $50,000 depreciation a year

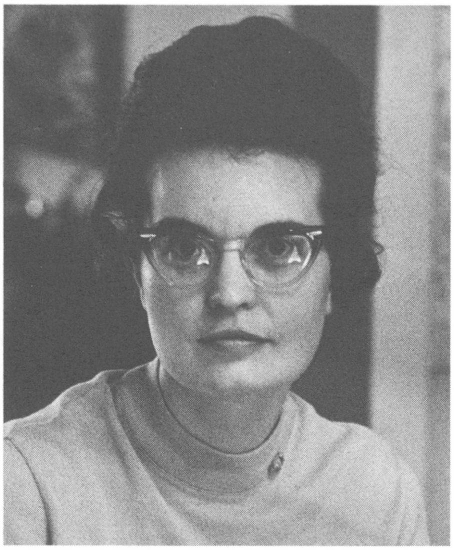
Equipment cost to Cooper is same as to Austin	$1,000,000
Accumulated depreciation is $250,000 + 50,000	300,000

(See Gentry[2], page 132)

12. On June 30, 1972, the Ingalls Corporation sold equipment for $420,000 which had a net book value of $400,000 and a remaining life of 10 years. That same day the equipment was leased back at $1,000 per month for 5 years with no option to renew the lease or repurchase the equipment. Ingalls' rent expense for this equipment for the six months ended December 31, 1972, would be

a. $5,000.
b. $4,000.
c. $6,000.
d. $(14,000).

Continued on page 30



Financial Statements

A Comparison of Annual Bank Reports

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Two annual bank reports presented to me happened to be complete opposites in appearance and content. The annual report of the Banca Commerciale Italiana was a complete departure from that issued by the Sanwa Bank of Japan. How did they compare with reports issued by United States banks? For a comparative study approximately twenty-five annual reports issued by U. S. banks were selected at random. As a group, these were similar and uniform in content and format and, therefore, are considered as one for purposes of this article.

The Italian and Japanese banks are commercial banks offering a full range of customer services and offering them on an international basis. Both have offices located throughout the world. For comparative purposes the United States banks selected were restricted to *commercial* banks rendering services on an *international* scale.

Background

Some general information is given on these banks to acquaint the reader with the extent of their international banking activities.

The Banca Commerciale Italiana has its head office located in Milan, Italy. During 1972 a new branch was opened in Tokyo and offices were opened in Chicago, São Paulo and Ankara. The bank had many international branches and offices prior to 1972, including one in New York City.

Sanwa is one of the leading international banks representing Japan. New overseas operations are in Chicago, Hong Kong, London, Brazil, Singapore, Thailand, Hawaii and the New Hebrides Islands.

Two United States banks shall be specifically mentioned. The Bank of Hawaii has eleven branches in the Pacific Islands in addition to many on the five Hawaiian Islands. Tremendous growth and expansion of their banking activities has resulted recently from foreign investment in Hawaii and the tourist industry.

Bankers Trust New York has had a London office established since 1923 and by any measure ranks among the largest banks in the United States. Branches and offices are scattered throughout the world — Paris, London, Tokyo, Madrid, Rome, Sydney, and Mexico City. In 1972 a five-year $100 million Eurodollar loan was granted to the government of Yugoslavia; $70 million was loaned to the Korean government; and an eight-year $21 million loan was made to Brazil's Companhia Metropolitano de São Pãulo-Metro for construction of a new subway system.

The above-mentioned banks do international business and have offices scattered around the globe. Their services are comprehensive and the volume of transactions may be expressed in billions and trillions of lira, billions of Japanese yen, or millions of United States dollars.

At this point, the annual reports are discussed on a comparative basis as to appearance and format, content and length of the letter from the chairman of the board, the financial statements, and the auditor's report.

Appearance and Format

Sanwa's annual report is large and colorful; its glossy cover picturing the onion blossom. One-third of the total content contains pictures, charts, maps and diagrams. Its appearance immediately generates favorable reaction from the viewer.

Most American bank reports strive for the same favorable impression. Not all reports are colorful, some are black and white.

At the other extreme is the report issued by the Italian bank. It is small, about half the size of most annual reports, thick and housed in a plain brown cover. There are no pictures, no charts, no graphs. The cliché "you cannot tell a book by its cover" was never truer than in this case. Informative and comprehensive, the written report (discussed in detail later) can and does hold the reader's attention.

The content of each report generally included president's message, review of the economy, financial statements, and an auditor's report.

Letter by President or Chairman of the Board

The message from the president is usually two to three pages in length and gives a condensation of the year in review. A separate section may elaborate on this, but essentially the topics covered include personnel changes, growth and expansion, investments, the business climate and a brief financial review. The United States banks' annual reports devote anywhere from three to approximately twelve pages to a discussion of the above topics. This is not true of the Sanwa Bank's report nor of the Italian bank's report.

The nonfinancial section of the Sanwa annual report is in four parts:

1. Message from the President (three pages),
2. Review of the Japanese Economy (six pages),

3. International Banking (ten pages), and

4. Domestic Banking (six pages).

The president's message briefly discusses the international economy and monetary system, inflation, pollution and social responsibility, new international operations and finances. A review of the Japanese economy includes changes in domestic business conditions, housing construction and personal consumption and investments. As to international banking residents and nonresidents can open accounts in foreign currencies, bonds are floated in foreign currencies and business is promoted with foreign firms. Domestic banking covers complete customer service (ordinary and time deposit accounts, consumer loans, housing loans); an investment, trustee and securities department; and services in the near-banking field: credit cards, leasing, computer service and credit guarantees. Twenty-five pages, or approximately two-thirds of the annual report, are devoted to non-financial information.

By contrast the report submitted by the Board of Directors of the Banca Commerciale Italiana to the "Ordinary and Extraordinary Meeting of Shareholders held in Milan on 19th April 1973" devotes thirty pages out of a thirty-five page report to a lengthy written discussion uninterrupted by pictures, charts or tables. However formidable it first seems, this becomes fascinating reading as the Italian bankers discuss the economic community in which they must conduct business. On page eleven they stress the

> "need to restore a monetary system that will avoid a return to economic autarky and isolationism and so facilitate the recovery and growth of international trade. . . ."
>
> "The world scene is increasingly occupied by big multinational companies whose activities accentuate and promote international economic co-operation, but which at the same time, partly due to the fact that they manage funds in a wide range of currencies, impair the control exercised by the national monetary authorities."

This quote comes from page 12:

> "As you know, the last months of 1972 were marked by outbursts of trade union agitation and strikes, some of which . . . was reflected in a large backlog of work, which reached a peak at the end of the year, so that we were obliged to carry forward many transactions required by customers in the last two months, which in a normal situation would have been completed before 31st December . . . Thus, it is estimated, we think fairly accurately, that the year-end totals were swollen for the reasons indicated above by some Lire 300 billion in the case of deposits on current account and by Lire 250 billion in the case of lire advances on current account and bills discounted."

Unique within the Italian Board of Director's report is a detailed description and discussion of all balance sheet accounts including percentage changes and analyses of what brought about these changes.

The report continues in great detail on principal bonds issued to the public, markets for foreign securities, lack of business investment in fixed assets, the economic consequences of unutilized plant capacity. Extremely well written, it further elaborates on the international money market, exchange rates and capital movement.

The Financial Statements

The balance sheets appearing in the annual reports of the Italian, Japanese and United States' banks were fairly uniform. Classifications, with the items generally appearing under each, were as follows:

Assets:
- Cash and Due from Banks
- Investment Securities, Treasury Bills, Mortgages Bonds
- Loans and Bills Discounted
- Bank Premises, Equipment and Real Estate
- Customers Acceptance Liabilities and Guarantees
- Accrued Interest
- Foreign Exchanges

Liabilities:
- Deposits (demand and time)
- Acceptances and Guarantees
- Liability under letters of credit
- Accrued Expenses
- Dividends Payable
- Unearned Income
- Foreign Exchange
- Reserve for Price Fluctuations
- Reserve for Possible Loan Losses

Capital:
- Common Stock or Paid-Up Capital
- Legal Reserves
- Retained Earnings or Other Surplus

The Italian bank's report combined capital and liabilities under the heading of "Liabilities."

Greater variety appeared in the format and terminology of the income statement. Therefore, the outline is given for a United States bank report, the differences noted between it and the Japanese and Italian statements follow.

Operating Income:
- Interest and fees on loans
- Interest and dividends on investments
- Fees and Commissions
- Other Operating Income

Operating Expenses:
- General and Administrative Expense
- Interest on deposits, borrowings, rediscounts
- Net occupancy expense of banking premises
- Other expenses

Income Before Taxes
- Applicable Income Taxes

Net Income

Variations concerning the income statement were:

1. The title "Profit and Loss Account" replaced "Consolidated Statement of Income" as the name of the statement in both the Italian and Japanese annual reports.
2. The Italian report used "Return on investments and funds employed" in place of the classification "Operating Income."
3. Variations on "General and Administrative Expense" were "Salary and Employee Benefits" and "Cost of Staff."
4. Depreciation of buildings and plant often were separated from occupancy cost.
5. The United States bank statements usually showed earnings per share on common stock.
6. The Italian bank's profit and loss account was a single-step statement listing expenditures first, followed by return on investments.

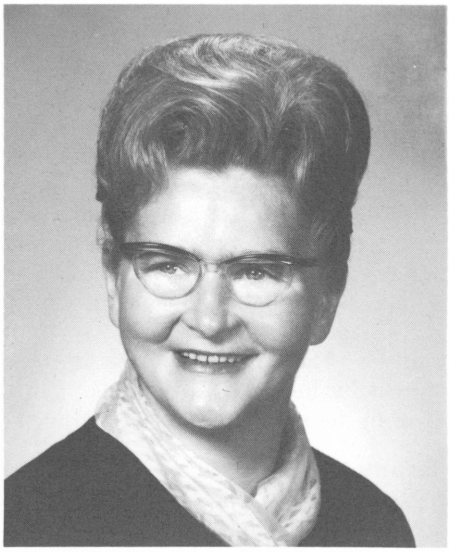
A few more similarities and dissimilarities concerning the financial statements in general were:

1. Comparative statements were given for at least two years, the current year and the prior year.
2. An analysis of the change in the liability account "Reserve for Loan Losses" was given in one of three ways: by footnote, by supporting schedule, or within the president's or board chairman's report (Banca Commerciale).
3. A Statement of Changes in Capital accompanied most of the financial statements.
4. A Statement of Changes in Financial Position appears only in the annual reports of the United States[1] banks.

The Auditor's Report

Annual reports of the United States banks contained the standard shortform, unqualified report. At the other extreme, the Sanwa bank's annual report contained *no* auditor's report. The Banca Commerciale Italiana report contained a Report of the Board of Auditors, which may be an external body comparable to an indepen-

Continued on page 28



Small Business

The Balance Sheet — Barometer of Business

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Even though to many investors the profit and loss statement is of utmost importance, management can tell a lot about the condition of the business by even a cursory look at the balance sheet. Of course, the "insider" sees the balance sheet more frequently, and the changes tell part of the story. Viewed just once and then at statement time, it may not be nearly as informative. Therefore, this article is written from the management point of view.

The Western World is trained to read from left to right and the left-hand side of the balance sheet is the domain of the assets. Therefore, the assets will be considered first.

Cash

The first item on most companies' balance sheet is cash, probably the most active account, since just about every transaction runs through cash at one time or another. If the cash account is "fat" it may give some management people a comfortable feeling. But that may be very deceiving. If cash has some equally "fat" companion over in the short-term borrowing section, the business may be better off with lean cash and less borrowing. Admittedly, banks do not make the planning of cash flow too easy, and in times of tight money, a business may be forced to carry large sums of borrowed capital which, at least at times, may be idle in the cash account. None of the lenders like short-term credit to be on a daily basis — least of all the banks, since the paperwork that they have to process is of mammoth proportions even without borrow-today and pay-back-tomorrow transactions. Computers have come to the rescue to a degree, and some banks have established such systems as "overdraft protection" or "ready reserve" arrangements, which in effect are a daily fluctuating loaning procedure. Every check written in excess of the bank balance constitutes a prearranged loan and every deposit made in the checking account constitutes a repayment in part or in full. The rates of interest are high, but since the money borrowed may be owed for only a short period of time, this arrangement is often cheaper than 90-day renewable notes.

An alternative — also a fairly new aid to the business community — is being offered by Savings & Loan Associations with daily interest-paying accounts. All receipts are deposited in the S & L, and transfers to the checking account of any bank in town are made by the S & L usually the same day and upon telephone notice. The interest earned by the account on deposit with the S & L can offset some of the cost of borrowing at the bank. The only problem here is that the bank might become "difficult" when it sees that it is losing the compensating balances in the checking account. To counteract this loss of available money in the checking accounts, some banks have started to pay daily interest on the balance in checking accounts. It is a highly competitive business, and for once management has some bargaining power.

Accounts Receivable

Some businesses are almost entirely on the cash basis as far as their sales are concerned — and they should consider themselves very lucky. Accounts receivable are a valuable asset, but they become ever so much more valuable when they are turned into cash quickly. Inflation robs the business that must wait for payment for prolonged periods of time. Economists view a 5½% annual inflation rate normal these days, and dark and gloomy predictions place the expected 1974 rate closer to twice that much. Therefore, a six-month delay in receipt of payment can conceivably cause a 2-6% loss in purchasing power — in addition to the cost of borrowed money if the seller is cash-poor.

Of course, there are many ways of turning receivables into cash immediately — factoring, minimum waiting for collection procedures, but again it costs money to have somebody else collect the money, and careful study is required to determine the method of handling accounts receivable which will yield the highest return or cause the least expense.

Prepaid Expenses

Convenience or necessity? That is the question for this category, and insurance premiums are a good example. They must be paid at the beginning of the policy period (or at least within the 30-day grace period). For the convenience of the customer and to ease the pain of paying several thousand dollars at one time, many insurance agencies offer level premium payments. In most cases, the full premium is still prepaid for a period of from six to twelve months at the policy anniversary, and that means that part of the premium is now prepaid 18 to 24 months!

Escrowed taxes! At best, the escrow agent will pay bank-rate interest. This should be compared with the value of the money in the coffers of the business.

Property and Equipment

Here the question becomes: Rent, lease or buy? Or buy, sell and lease back. Many businesses do not have a choice about their plant. They are so specialized that they are forced to build their own facilities to their own specifications. But, especially with an eye towards inflationary loss of purchasing power, it might be worthwhile to sell the facility upon completion and lease it back. In many cases this may mean the difference between inadequate facilities and room for expansion.

In the area of machinery and equipment the question becomes even more worthy of careful study, since such considerations as obsolescence, possible expansion into related lines of business and the market for used equipment come into play. Naturally, the leasing companies are in business to make a profit, but a thorough study of cash flow requirements and the cost of interest on borrowed money may show some surprising results.

Aside from the rent-lease-or-buy question, the "fixed assets" of a business deserve the closest of scrutiny. Too much equipment, especially in the early years of a business, can put it into a cash crunch that could be fatal. Not enough equipment can mean additional and unnecessary labor costs or missed business opportunities.

In the office equipment area, the good "buys" in used equipment should not be overlooked. Sometimes they are truly amazing.

When it comes to automobiles and trucks, the leasing versus buying proposition has as many staunch supporters as opponents. The dictates of the business are the only valid criteria. These are extremely heavy usage and rapid turn-over, repair service, availability of loan equipment during repair down-time trade-in values of owned equipment, length of lease term, insurance costs, etc. The add-on interest rates in this type of financing and the lease costs are probably very close.

Other Assets

Marketable securities. For the business that has cash reserves earmarked for future expansion, temporary investments in Treasury Bills, Certificates of Deposit or other short-term investments are preferable to having the cash in the checking account. When the demands on these reserves are further removed in time, the choice of the investment vehicle becomes more involved and probably centers around such matters as liquidity, income yield and inflation hedges. The stock market's unpredictability and nose-dive trends of late are enough to give management nightmares, real estate may not be capable of ready conversion to cash when needed, and bonds are subject to inflationary losses. Astute managers to the fore, please!

Required deposits, organization expenses and the like are, in most instances, removed from managerial influence and of very minor importance.

Cash surrender values of life insurance policies. Here is a ready source of working capital and a potential time-bomb at the same time. The interest rates in these contracts are most attractive. But it may well be that the proceeds are needed immediately in the event of the untimely passing of one of the officer-stockholders, such as in a funded buy-out agreement. On the other hand, if the money is to be used to tie the business over until a replacement for a key person can be found, the need for all of the life insurance proceeds may not be immediate, and the business may have a chance to generate the cash by which the insurance pay-out is short due to the loan.

The above is not represented to be a complete list of assets but merely highlights the items found on most balance sheets of small business entities.

Liabilities

The other side of the ledger naturally has the opposite set of rules. Heavy liabilities, especially short-term debts, make management uneasy. Still, the doctrine prevails that the business is operating on somebody else's money, and if these funds are put to good use in the business, the inflationary depreciation of purchasing power can work in favor of the borrower.

On the other hand, discounts take a direct route into profits, and discounting can brighten up an otherwise mediocre profit and loss statement. Therefore, managing accounts payable is really planning for cash flow.

Management must insist on proper accruals of such items as taxes, interest, excess rentals, payroll and other expenses, to be able to make intelligent decisions.

Short-term versus long-term borrowing. Management should make a very realistic appraisal of the working capital requirements of the business to decide whether to go with continuous or repetitive short-term loans or whether it would be more advantageous to seek long-term financing, with or without personal guaranties. In part due to the insistence of lenders, long-term financing is largely limited to real property. But other property, such as "Blue Chip" stocks, insurance policies and bonds, often is acceptable as collateral.

A corporation could float a bond issue, maybe even with a conversion feature to make it more attractive to investors. A partnership or sole proprietorship may have to pledge personal assets of its partners or owner to obtain favorable long-term loans.

The important fact is that a long-term loan will be repaid with at least partially inflated dollars in the future, while the influx of cash enables the business to take advantage of present business opportunities. The value of money is determined by the number of times it turns over in the business cycle.

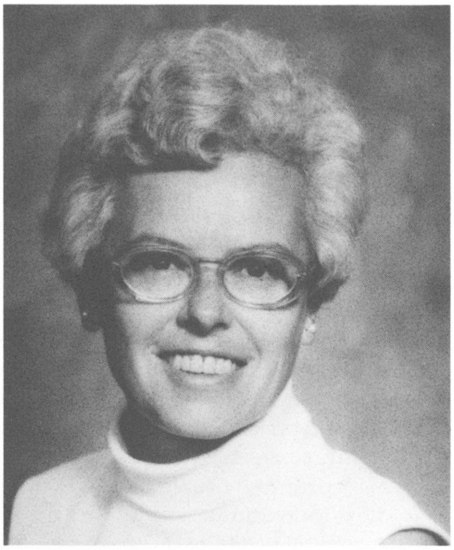
Equity

The safest source of money is, of course, equity capital. While it is a good investment to the new shareholder or partner when the businessis successful, strong capitalization enables the business to pass more of its profits through to retained earnings and thus back to the stockholders, partners or investors.

In a closely-held corporation, the acquisition of new shareholders may create problems, since the original stockholders are generally very experienced in their fields and used to making decisions without asking anyone else. A second class of stock, without voting rights, can be the answer. It gives the financier the right to share in the profits but not the right to interfere with the day-to-day business decisions. If necessary to attract investors, the second class of stock can be preferred stock with definite and well-defined dividend policies, and again this can be non-voting stock.

A partnership can acquire limited partners with all management duties remaining with the general partners. A sole proprietor can change the business to a limited partnership to obtain equity capital.

It is obvious that management has the obligation to review the balance sheet barometer often and thoroughly, and that it must insist that the facts and figures be accurate. No decision is worth more than the information on which it is based. The balance sheet will be a pretty good indicator of "clear sailing" or "storm brewing on the horizon".



Tax Forum

The Accumulated Earnings Tax Penalty — and How To Avoid It

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Section 531 imposes an accumulated earnings tax on a corporation which fails to distribute its earnings and profits in order to avoid the income tax with respect to its shareholders. The tax, which is punitive in nature, is in addition to the regular corporate income tax and is assessed at the rate of 27½ percent of the first $100,000 of "accumulated taxable income," and 38½ percent of any excess over $100,000. Section 535(c) provides an accumulated earnings credit of $100,000 before the penalty of Section 531 is imposed. This credit is denied multiple corporations formed to avoid tax, and is limited in the case of certain controlled corporations. In arriving at "accumulated taxable income" there are certain adjustments for charitable contributions, dividends received deductions, capital gains and losses and operating losses as set forth in Section 535(b).

To show the effect of Section 531 let us assume a corporation has taxable income of $200,000, pays a regular tax of $89,500, distributes no dividends and has accumulated earnings and profits of $100,000 at the close of the preceding taxable year. There are no other adjustments in arriving at accumulated taxable income. Therefore, 531 tax in the amount of $31,437.50 will be imposed on $110,500 ($200,000 - $89,500) leaving net earnings in the company of $79,062.50. In this example, corporate profits have been taxed away at a rate in excess of 60%.

If we go one step further and assume that the remaining profits are distributed to noncorporate shareholders in the 50 percent tax bracket, another $39,500 in taxes will be assessed at the individual level. The final result is $39,500 of spendable income from $200,000 of corporate profits, or roughly 19½ percent. Had the directors of the corporation chosen to distribute rather than accumulate income, its stockholders could have had $55,250 in after tax dollars.

With the exception of Trico Products Corp. in 1942 (46 B.T.A. 346), the accumulated earnings tax had not been applied to publicly held corporations until it was assessed recently in 1972 against Golconda Mining Corp. (58 T.C. 139). Generally, pressure from stockholders of publicly owned corporations will result in dividend payments that will assure a reasonable balance between funds retained for corporate operating or expansion needs and those made available for distribution to shareholders. It is the private or family corporation with only a few stockholders that is more likely to retain profits in excess of reasonable business needs in order to avoid additional tax at the shareholder level. Although the stockholders of Trico Products Corp. numbered more than 2,000it was rather a hybrid since six controlling shareholders owned approximately 74 to 78 percent of the stock in the years it was held subject to the accumulated earnings tax. For this reason, the court had no difficulty in determining that corporate profits had been purposely retained to avoid additional tax with respect to its controlling shareholders. As a result of this assessment, the other stockholders brought a suit for mismanagement against the directors of Trico who paid the Corporation over $2,000,000 in settlement.

In the Golconda case there was also broad public ownership with between 1,500 and 2,900 shareholders during the period at issue. Unlike Trico, no more than 17 percent of Golconda stock was owned or controlled by its management group. In concluding that a public corporation could be subject to the accumulated earnings tax the court acknowledged that it would only occur "where the fact of public ownership is neutralized by the manner in which the company has been managed." The court enumerated two situations that might possibly "neutralize" the public ownership factor:

1. Domination of management by either one shareholder or a small group with large stockholdings who could exercise effective control over corporate dividend policy.

2. A corporation that represents itself to prospective or existing shareholders as being an investment company with a policy of accumulating its investment income, i.e., a growth company.

In 1966 Golconda used current earnings and profits in redemption of its own stock relative to a merger with Hecla Mining Company. The tax court found that the merger in question was not motivated by the business requirements of the corporation, but was instead accomplished for the benefit of the shareholders. The dominant officer-director-shareholder of Golconda had avoided some $26,000 in individual income taxes and another director more than $11,000 through the corporation's decision not to distribute all of its earnings and profits in 1966. These facts together were considered sufficient evidence to determine that an accumulated earnings tax had been properly assessed for the year 1966.

It remains to be seen whether the Golconda case will provide new vistas for the Internal Revenue Service in the area of Section 531 assessments. This case certainly emphasizes the fact that corporate directors should always weigh carefully the matter of distributing earnings, particularly so, if dominant shareholders will realize substantial benefits from the accumulation of earnings rather than the distribution.

In 1971 the distribution of corporate earnings was curtailed as a result of limitations imposed under wage and price controls. The Service issued Revenue Procedure 72-11 (1972-1 C.B. 732) the following year in which it held that excess accumulations would not be subject to accumulated earnings tax to the extent that earnings could not be distributed without violating dividend guidelines under Phase I and II of the Wage and Price Stabilization Program. In addition, this procedure brought under its "protective umbrella" all corporations not technically subject to the guidelines that also accumulated earnings in order to comply with the spirit of the program. This meant that all corporations who paid out the maximum allowed by the dividend guidelines could accumulate the balance of their earnings and profits with impunity. The present maximum dividend distribution permitted is the greater of (a) 25 percent of the previous year's net income (after taxes and preferred stock dividends), (b) an aggregate cash payment per share that does not exceed the amount allowed in the prior year by more than 4%, or (c) an aggregate cash payment per share that, as a percentage of per-share profits after taxes in the last completed fiscal year, does not exceed the corporation's last five year average payout ratio. The temporary protection afforded corporations not subject to the guidelines has now been revoked by Revenue Procedure 73-33 effective for taxable years ending after December 31, 1973. It is anticipated that before this column reaches print all restrictions on dividend distributions may have been removed, leaving corporations again completely vulnerable to Section 531 attack.

The fact that a corporation has accumulated earnings and profits in excess of $100,000 is not conclusive evidence that income has been retained for the purpose of avoiding tax at the shareholder level. Prior to 1954 a corporation's only defense for retaining excess earnings was to prove lack of intent based solely on the subjective motives of its shareholders. Today, this negative proof or "Subjective test" has been supplanted by the more serviceable "objective test" or reasonable needs, including reasonably *anticipated* needs, of the business (Code Sections 533(a) and 537).

Under the objective method, the capital structure of the corporation should be examined in order to first determine if funds are available for dividend distribution. If the balance sheet indicates that earnings have been invested in plant and equipment and/or are required for the payment of deferred charges there may be no working capital available for distribution to shareholders. Furthermore, Regulation 1.537-2 provides that future needs of the business, i.e., bona fide expansion, plant replacement or acquisitions will support and be considered adequate reason for the retention of earnings. Planning for future requirements should be factual and verified by reference in the minutes of meetings held by directors and stockholders of the corporation. Vague plans for future expansion that never materialize will be of no value in defending a proposed Section 531 assessment.

Working capital required for the normal operating costs of a business has been the focal point of many accumulated earnings tax litigations. In its simplest form working capital is represented by the excess of current assets over current liabilities and identifies the relatively liquid portion of total capital (stock and retained earnings) available as a margin or buffer for meeting obligations within the normal operating cycle of the business. Once working capital has been determined the next step is to compute the operating turnover or cycle formula. This has been developed and offered as a "practical" means of calculating the amount of current earnings a company should retain to meet its day-to-day operations. The operating cycle is generally that period of time required to convert cash into raw materials, raw materials into inventory, inventory into sales and accounts receivable, and the period required to collect outstanding accounts.

The mathematical formula established in the Bardahl Manufacturing Corp. case for measuring the operating cycle of a business has frequently been the basis used in defense of accumulating earnings (T. C. Memo 1965-200). Since operating expense requirements generally vary from industry to industry, modifications are usually required for each individual situation. For example, Bardahl International Corp. tempered the operating cycle formula when applied to a sales corporation by including a credit factor for the time payment period allowed by trade creditors (T. C. Memo 1966-182). The annual cost of goods sold plus total annual operating expenses (excluding depreciation and federal income taxes) is multiplied by the operating cycle percentage to arrive at working capital requirements for one complete operating period. In two later cases following the Bardahl decision a new concept of using peak rather than average requirements for inventory and receivables was introduced, permitting more funds to be retained to cover operational outlay. (Magic Mart, Inc. 51 TC 775 and Kingsbury Investments, Inc. T.C. Memo 1969-205).

Another method for computing the minimum reasonable needs of the business is the use of available liquid capital rather than available working capital. Instead of considering all current assets net of current liabilities as available to carry operating expenses, only liquid assets (cash, marketable securities and other assets readily convertible into cash) are considered currently usable for continued corporate operations and growth. This method employs the cash cycle approach rather than the operating cycle concept in determining reasonable needs of the business.

Cash cycle includes the costs and expenses (net of depreciation) that are expected to be incurred during the procurement and delivery period of corporate operations. Unlike the operating cycle method, the cash cycle does not generally include a collection period, since under normal business conditions the collection period operates contemporaneously with the procurement-delivery period. Available liquid capital is arrived at by deducting from equity capital the amount required to carry noncash assets (receivables, inventories, net plant and equipment, etc.) and adding back capital borrowings represented by current and long-term liabilities. Under the cash cycle approach payments of debt obligations, replacement of maximum inventory, operating and other expenses for one cash cycle (less depreciation) and capital additions in the following year are considered reasonable and necessary for normal business operations.

It should be emphasized that there has been no completely accepted procedure established for computing the operating or cash cycle requirements of a business. Each case will generally stand on the relative accuracy and reasonableness of its own method.

A related problem in the case of a closely-held corporation is financing the payment of death taxes and estate expenses where the bulk of the decedent's assets consists of stock in the family corporation. Unless the estate and heirs have sufficient other liquid assets to pay the taxes and expenses a sale of corporate stock will be necessary in order to provide the cash required. If the corporation doesn't redeem the shares, this situation

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Personal Management

Selecting a Home

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As a new regular column of *The Woman CPA*, this department will discuss various topics as they relate to the professional person. Examples of such topics are selecting a home, life insurance, other types of insurance, investments, estate planning, and planning for retirement. This issue will discuss selecting a home.

The first of two decisions should be whether you want to live in multi-family housing where several residences are included in one building or whether you want to live in a single family residence. The cost to you as the consumer will vary depending on the demand for the quality and neighborhood; however, the hard cost for comparable units will normally favor the multi-family facility because less land is needed per unit and some of the walls are common to two residences. The costs, while important, probably will not be the deciding factor.

Some of the other factors which you should consider in making a choice are: (1) What amenities (including recreational facilities) do you want; (2) Do you want to socialize with your neighbors, and if so, what type of neighbors do you prefer; (3) Where do you want to live and what type living facilities are available there; (4) Do you have a strong emotional tie to a particular type of housing; and (5) What amount of time will you devote to repairs and maintenance. Each of us has preferences which must be considered.

Multi-family housing frequently offers many amenities for a minimal cost because the costs of the amenities are covered by a large number of residents to whom the facilities are available. For the single family dweller to have access to comparable facilities, at least one club membership would probably be required. Because of the location, the multi-family dweller will probably find the facilities available more convenient than a club's facilities are for the single family dweller. However, a person's job might dictate membership in various clubs which make the desired facilities available.

You must also consider if you want to socialize with your neighbors and what type of neighbors you want. Many multi-family housing projects aim at a specific group such as retired people or young single people and frequently plan activities which would appeal to the specific group. However, some recent single family developments also offer the same type of planned activities. This is a relatively new area for single family developers who are learning from the multi-family developer that amenities attract people.

You should consider the area of a city in which you want to live in making your decision. The distance to your job, shopping areas and entertainment should be considered. There could also be other factors affecting a choice of location. Within most large cities, there are many small communities; most are composed of people from specific economic or ethnic groups. Be sure to consider in which communities you would feel comfortable.

If you have always lived in a house, you may have a strong emotional attachment to the advantages a house offers. If this is the case, and you are considering buying a condominium, you might consider renting an apartment for a period of time to find out if you can make the adjustment to multi-family living. The same certainly would be true if you are accustomed to multi-family living and are considering a switch to single-family living.

The single-family house should provide the most flexibility for you to be an individual. Generally, the additional green space allows you to landscape as you choose. Also, if you are a single-family owner, you can, within the confines of building regulations, add on to a house whereas a multi-family owner is normally limited by deed restrictions which would not permit expanding the facility. While single-family housing provides an opportunity for individualism, it also requires time or money to hire maintenance and repair work such as mowing the lawn.

There are probably other considerations which apply specifically to you which should be weighed together with those previously discussed. You should consider all the pros and cons of each type of housing as they apply to you. Concurrent with the decision on single-family versus multi-family, you must decide whether you want to buy a home or rent one.

Again, there are several factors which you should consider in deciding whether to buy or rent. Some of the factors are: (1) Your expectations regarding future economic conditions, (2) possible tax savings, (3) potential resale values in light of your future plans, and (4) your right to make improvements versus your responsibility to maintain and repair.

With the recent inflation coupled with rising costs of land and building materials, home ownership has been a good investment and a good hedge against inflation. You must now pull out your crystal ball and find out what will happen to the economy in the future. If you believe rising costs and inflation will continue, then home ownership is generally a good investment. Buying in the right area is a must. As slum areas are being cleaned up, new ones develop; the values in the newly developing slum areas normally drop or at least increase at a pace much slower than in areas away from slums. Get to know the area before you buy so that you do not get into a deteriorating area.

Interest on home mortgages and real estate taxes is currently deductible as itemized deductions for Federal income tax purposes. (Federal income tax provisions are, of course, subject to change.) Depending on your income tax bracket, other itemized deductions and the standard deduction available to you, you could save substantial amounts of federal income tax by owning a home.

The resale market for any home you might consider purchasing should be very important to you. For example, if you buy a house or condominium in a new development which will take several additional years to complete, you should plan on staying for awhile. The resale value will probably rise at a much slower pace while new units are available than after the development is completed. Therefore, if your plans include future moves, consider the timing of those moves in regard to resale of any residence you may purchase. Also, in many areas, condominiums are rather new and a good resale market has not yet been established.

Since an owner is normally responsible for maintenance and repairs, this should be a consideration in your choice. As a tenant, the costs of maintenance and repairs are covered by rent. However, the owner of a number of properties may employ people to do this type of work on a full time or part time basis which should decrease the cost per repair below the cost to a homeowner of a single unit. As an owner, you have the right to improve your home which may be important to you. A tenant normally would not have that privilege.

Like the choice between multi-family or single-family, whether to own or rent requires consideration of your specific situation.

The previous discussion has centered completely on multi-family versus single-family housing and home ownership versus renting; another possibility would be to buy a duplex or small apartment building which combines home ownership with investment. This alternative limits the choice of selection relating to the type of housing and location. If you wish to explore this possibility further, you should be analyzing the investment potential as well as selecting a residence. An investment property may offer a tax advantage due to accelerated depreciation, it may allow payment of the mortgage for the rental unit or units and at least part of your residence from rental income, and it would allow you to keep a close watch on your investment. It could also be a headache to you since the management would be your responsibility. For a fee, probably five to seven percent of rental income, you can hire someone else to manage the property. If you are interested in long range investing and home ownership, this possibility deserves consideration.

In light of the current "energy crisis", there is one other alternative for a living facility which should be discussed. This alternative, with your employer's consent, would be a cot or a sofa in your office. This would be the ultimate in job convenience, and could save a considerable amount of commuting fuel and time. However, it would require some inconveniences when relaxing, entertaining, or sleeping. Your employer may even like the idea as you would be available more hours.

In conclusion, there are several life styles to choose from. Each of us is a unique individual and should consider one's own resources and desires in selecting a home best suited to oneself.

Electronic Data Processing
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successful information system. They can facilitate communication among the various divisions of an organization (especially communication between the computer staff and non-computer staff) by providing a common "vocabulary" and method of description, thereby speeding the communication process and eliminating time-consuming and expensive misunderstanding. In addition, adherence to carefully established standards can help simplify personnel training and evaluation.

The amount of documentation and the number of installation standards developed will vary from installation to installation. The size of the installation and the complexity of the processing it does will influence the degree of formality in the documentation and standardization processes. However, every information system should establish those criteria by which its performance will be evaluated, by which it will set its objectives, and by which it will document or record its procedures and accomplishments. Even the smallest installation must have some means by which it can guide its operation and communicate with its users as well as provide a means for modification of its activities and expansion of its applications.

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could result in a forced sale to outsiders thereby causing not only a possible loss of family control, but also a potential financial loss to the estate if the redemption is at less than fair market value.

Code Section 303, enacted specifically to avoid the above result, provides generally that a corporate redemption of stock from the estate of a decedent will be treated as a distribution in exchange for such stock if the value of the shares held by the decedent is either: (1) more than 35 percent of the gross value of the estate or (2) more than 50 percent of the taxable estate. Prior to the 1969 Tax Reform Act, the accumulation of corporate funds to finance such a redemption as a reasonable business need had been both successful (Mountain Steel Foundries vs. Comr., 284 F. 2d 757) and unsuccessful (Dickman Lumber Co. vs. U.S., 355 F. 2d 670) in defending against a 531 assessment. In 1969 Code Section 537 was amended to provide that the "reasonable needs of the business" would include Section 303 redemptions (Code Section 537(b)(1)). At the time the Act was written the Senate Finance Committee Report clearly stated that accumulations in the year of the death and later years to redeem stock in a redemption to pay death taxes should not be considered unreasonable. (S. Rept. No. 91-552.)

Although there are several defenses available for the accumulation of earnings over and above the allowable $100,000 credit, corporate officers and directors would be well advised to document support for such accumulations prior to a proposed Section 531 assessment by the Service. A schedule indicating the present and future requirements for business operations and specific plans for expansion should help avoid the expense and time involved in what might otherwise be a lengthy litigation of the facts.

Theory & Practice

The FASB — Action and Some Reaction

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With the organizational details of funding, selection of members and office facilities, and establishment of rules of procedure and of personnel policies completed, the Financial Accounting Standards Board was ready for action. Its initial agenda published in April 1973 was comprised of these seven items:

- Accounting for Foreign Currency Translation
- Reporting by Diversified Companies
- Accounting for Research and Development and Similar Costs
- Accounting for Future Losses
- Criteria for Determining Materiality
- Accounting for Leases by Lessees and Lessors
- Board Qualitative Standards for Financial Reporting

Two other projects, Accounting for Business Combinations and Related Intangibles and Reporting the Effects of General Price-Level Changes in Financial Statements, have since been added.

The decision to add business combinations was the result of the FASB's invitation to financial executives, analysts, accountants and other interested parties to submit comments on the need to replace, revise or interpret pronouncements of the Accounting Principles Board and the Committee on Accounting Procedure. Responses indicated that a complete reconsideration of Accounting Principles Board Opinions No. 16, Business Combinations, and 17, Intangible Assets, was needed and that this was the subject most urgently requiring attention.

The FASB's stated reason for adding price-level accounting to its agenda was the increase in the rate of inflation since Accounting Principles Board Statement No. 3, Financial Statements Restated for General Price-Level Changes. This statement concluded that, although not required at the time for a fair presentation of financial position and results of operations in conformity with generally accepted accounting principles in the United States, general price-level financial statements or information extracted from them was useful information and that it might be presented in addition to the basic historical-dollar financial statements. The FASB emphasized that, in its deliberations, consideration will be given only to price-level statements as supplemental information, not as a replacement of historical-dollar financial statements.

The ultimate product resulting from each of these nine projects is expected to be a Statement of Financial Accounting Standards. Several procedures are generally required to be carried out prior to issuance of a Statement of Financial Accounting Standards. First a task force is appointed to define the problem and its financial accounting and reporting issues, determine the nature and extent of research to be undertaken, and prepare a discussion memorandum outlining alternative solutions and the arguments and implications relative to each. The task force is headed by a member of the FASB and includes persons with special expertise in the assigned subject. The experts chosen are not necessarily practicing public accountants, they may be financial executives or educators. A public hearing is held 60 days after issuance of the discussion memorandum. The purpose of the discussion memorandum is to serve as a basis for the public hearing and to solicit papers from interested persons and organizations. After the FASB has studied the papers submitted and testimony at the public hearing, an exposure draft is prepared stating its proposed position. Exposure drafts are issued only after an affirmative vote by at least five of the seven members of the FASB. Following exposure and evaluation of public comments resulting from it, a Statement of Financial Accounting Standards is prepared and voted upon by the FASB. Final approval also requires an affirmative vote by at least five FASB members. Completion of all these procedures takes a great deal of time. The FASB Rules of Procedure do permit the issuance of a Statement following exposure but without a public hearing if, in the judgment of the FASB on the basis of existing data, an informed decision can be made without a public hearing. This rule permitted the FASB to move with comparative speed in issuing its first Statement.

Although the subject of Accounting for Foreign Currency Translation is one of the projects on its agenda, the FASB determined in October 1973 that there was immediate need for standards of disclosure in this area because of continuing realignments of exchange rates, the number of accounting alternatives available, the diversity of practice, the lack of specific disclosure requirements in existing accounting pronouncements, and the limited amount of information concerning translation practices being disclosed by some companies with material foreign operations. Since previously completed research studies were available, only limited additional research was required and an exposure draft was issued for public comment on October 19, 1973. Statement of Financial Accounting Standards No. 1, *Disclosure of Foreign Currency Translation Information*, was issued early in December 1973, shortly after the expiration of the minimum exposure period. The Statement is effective for periods ending after November 30, 1973. It provides that the following information is to be disclosed:

- A statement of translation policies including identification of (a) the balance sheet accounts that are translated at the current rate and those translated at the historical rate, (b) the rate used to translate accounts in the statement of earnings (for example historical rates for specified accounts and a weighted average rate for all other accounts), (c) the time of recognition of gain or loss on forward exchange contracts, and (d) the method of accounting for exchange adjustments (and,if any portion of the exchange adjustment is deferred, the method of disposition of the deferred amount in future years).
- The aggregate amount of exchange adjustments originating in the period, the amount thereof included in the determination of income and the amount thereof deferred.
- The aggregate amount of exchange adjustments included in the determination of income for the period, regardless of when the adjustments originated.
- The aggregate amount of deferred exchange adjustments, regardless of when the adjustments originated, included in the balance sheet and how this amount is classified.
- The amount by which total long-term receivables and total long-term payables translated at historical rates would each increase or decrease at the balance sheet date if translated at current rates.
- The amount of gain or loss which has not been recognized on unperformed forward exchange contracts at the balance sheet date.

Illustrative notes containing the required disclosures are included in an appendix to the Statement.

In addition to Statement No. 1, the FASB has released the Discussion Memorandum relating to Accounting for Research and Development and Similar Costs (public hearing set for March 15, 1974) and the Discussion Memorandum relating to Reporting the Effects of General Price-Level Changes in Financial Statements (public hearing set for April 23, 1974). As explained above, the discussion memorandum merely sets forth the issues and related arguments and implications and does not state any conclusions.

While the FASB has not as yet issued any interpretations of existing pronouncements of the Accounting Principles Board and the Committee on Accounting Procedure, it has the authority to do so. The procedure is much simpler than that required to issue a Statement. The proposed interpretation must be submitted for comment to the members of the Financial Accounting Standards Advisory Council (the separate advisory group established under the Financial Accounting Foundation) for a period of not less than fifteen days. The FASB may expose a proposed interpretation for public comment at its discretion. An affirmative vote by at least five of the seven members of the FASB is required for issuance of an interpretation.

From this brief review of the accomplishments of the FASB it is obvious that the prodigious pronouncements which were expected by the accounting profession, the financial community and others concerned with the reliability of financial statements have not materialized. The auditors' assurance that a company's financial position and results of operations are presented in accordance with generally accepted accounting principles is still being questioned. The financial analysts and the astute investor study the financial statements and related notes to determine which generally accepted accounting principles are being applied. Earnings of companies who consistently adopt the most liberal accounting methods and who present inadequate disclosures concerning the principles followed are often considered suspect. Subsequent events sometimes prove that these suspicions were well founded. It should not be forgotten that if the FASB falters, the Securities and Exchange Commission and other governmental agencies stand ready to do what the accounting profession cannot do for itself.

While the FASB's decision to add business combinations to its agenda was a result of responses to its own request for comments on prior pronouncements, the SEC's issuance of Accounting Series Release No. 146, *Effect of Treasury Stock Transactions on Accounting for Business Combinations*, must have influenced the decision to some degree. The SEC's influence seems more obvious in the decision to add price-level accounting to the FASB agenda which followed so closely the SEC's issuance of ASR No. 151, *Disclosure of Inventory Profits Reflected in Income in Periods of Rising Prices*. The Commissioners and the Chief Accountant of the SEC have expressed their desire to support and work with the FASB. The Chief Accountant, John C. Burton, has characterized the relationship of the SEC and the FASB as one of mutual nonsurprise where each must advise the other of how they are thinking and what they are doing. On December 20, 1973, the SEC issued ASR No. 150, *Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards*. This release states:

> ". . . the Commission intends to continue its policy of looking to the private sector for leadership in establishing and improving accounting principles and standards through the FASB with the expectation that the body's conclusions will promote the interests of investors."

However, the release also states:

> "The Commission will continue to identify areas where investor information needs exist and will determine the appropriate methods of disclosure to meet these needs."

While the SEC's confidence in the FASB and its desire to work with the FASB is now well known, the SEC's impatience with the FASB is also well known. In a recent speech, Commissioner Sommer pointed out that the FASB must first adopt a policy of deliberate speed. The FASB's handling of the price-level accounting project does seem to indicate an attempt at speedy action.

Financial Statements
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dent accounting firm in the United States. An external board would represent the government and a bargaining process would ensue over the amount of profits on which taxes are to be paid. An internal board would be part of the bank's staff.

Summary

The major differences may be summarized as follows: The letter to the stockholders submitted by the president or chairman of the board was two to three times longer in the Italian and Japanese bank reports as compared to the length of the same letter in the United States bank reports, as they discussed in much greater depth the national and international financial andeconomic conditions. The income statements varied in format and contained differing account titles. Only reports issued by United States banks contained a Statement of Changes in Financial Position. These same reports illustrated more financial information by use of charts and graphs. And, the auditor's report ranged from "no report" to the standard unqualified report.

Reviews

Writings in Accounting

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"THE MANAGEMENT ACCOUNTANT AND CREATIVITY," J. B. Edwards, MANAGEMENT ACCOUNTING, September 1973.

As the economy changes rapidly, as business expansion extends across national boundaries, as big business gets bigger and social pressures get stronger, the expectations and demands placed on management accountants are becoming more and more diversified and are more of a top-level management nature. The day has gone when the accountant's primary function was to push a pencil and pound an adding machine, grinding out reports on existing data alone, buried in the daily flow of information. Computers have taken over most of the detail work and management will depend more and more on accountants for decision making and projections, new ideas and concepts, and a multitude of other advisory services.

This article deals with the need for future accountants to possess the ability to think creatively. Creativity is the basic tool, without which the future management accountant will not be able to function effectively.

The definition of creativity considered to be the most useful for management accountants is "the rearrangement of past experiences." The author contends that there is creativity present in all people, that it is not a God-given talent possessed by only a few, but a quality which all people possess to some degree, many times never developed. Creativity is not directly related to intelligence levels, but is a "whole way of life." The characteristics present in a creative person are set out for the reader, followed by a series of simple, yet very effective tests gauging creativity.

Although no specific mention is made of this principle, the analysis of creative thinking basically describes the science of cybernetics, i.e., the key to success lies in people's self-image. With their mind, they define the "area of the possible," thereby setting outer limits on what they can do. Many people, according to this principle never develop their full potentials in life, primarily because of preconceived notions which produce self-images that are actually inferior. Mr. Edwards states, as do the cybernetics experts, that people are self-hypnotized by false beliefs, deterring creative thinking simply because of a lack of confidence. These principles are illustrated very effectively by the use of several short, simple tests of the way one thinks. The manner in which such simple tests demonstrate such profound concepts about human nature is quite astonishing.

Following the tests, Mr. Edwards outlines the creative process, which involves four basic steps — preparation, incubation, illumination, and verification. Older accountants are encouraged to disregard the general notion that creativity comes only from the young. Several examples of creative persons who made their greatest achievements at an older age are given. Finally, a step-by-step plan for development of creativity is set out for those who want to improve.

While persuading people to use their imaginations to guide them to success is not an easy job, there are those who can and will develop creativity. The accountants who possess this quality of creativity will be valuable to management. This article provides accountants with excellent food for thought as well as guides for improvement and should be very beneficial, not only to management accountants and their firms, but to those in other fields of management as well. The article is easy to read and the self-tests are simple and easily performed. The information presented should benefit anyone who reads and utilizes it for personal development.

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"SQUARING ACCOUNTS," Neil Ulman, THE WALL STREET JOURNAL, Volume LII No. 53, September 14, 1973.

British auditors, according to Mr. Ulman's article, have initiated action to reflect inflation effects in company reports, and this proposal has raised quite a stew in business, public, and government circles. The resulting storm of protest and controversy arises from the fact the proposed adjustment procedure can halve conventional profits or even turn them into losses.

This "squaring of accounts" to reflect the declining purchasing power of money raises major political questions on tax policy and government anti-inflation efforts. The article states that Mr. Walber, the British Minister for Trade and Industry, has notified Parliament that his department and the Treasury will jointly conduct a government inquiry into inflation accounting and its implications. Mr. J. Michael Renshall, Technical Director of Britain's Institute of Chartered Accountants, which sets standards for company reports, has stated that the governmental inquiry might delay but cannot prevent the adoption of an inflation-accounting standard.

Rough application of the inflation adjustment to published company reports gave startling results. For examples: the published profits for last year of Imperial Chemical Industries (which rivals Du Pont for the title of world top chemical producer) would have been roughly halved; Plessey Company (large electronics concern) would have had a 52%

cut in profits; and International Computers (Europe's largest computer maker) would have turned an $8.1 million *profit* into a $17.9 million *loss.* Mr. Ulman states (and logically so) that apparently much the same thing would happen to the published profits of U. S. companies.

Mr. Renshall of the British Institute stresses the urgency of recognizing the inflationary "facts of life" by suggesting that a good grasp of inflation accounting might have prevented the Rolls Royce collapse. The Institute is quite concerned that the British government inquiry into this accounting proposal might delay its goal of requiring companies to show inflation-adjusted accounts along with conventional figures in their 1974 annual reports.

The British government has denied any obstructionist motive; it feels a wider and deeper discussion of the proposal is warranted before the country rushes into such an accounting change-over with its widespread implications. The government particularly wants an examination of inflation-accounting effects on taxation and the flow of investment.

Inflation-accounting tends to increase profits for high-debt real estate holding companies and to cut reported profits of manufacturers with heavy capital investments. Accordingly, such accounting could switch some of the tax burden from the manufacturers to real estate firms.

Mr. Ulman's article states that only a handful of British companies have so far voluntarily presented their annual reports in terms of inflation-accounting, but more say they will be doing so this year.

Such action will undoubtedly spur other accountants (worldwide) to fulfill their financial responsibilities and attack the obvious reluctance of companies to publish profit revisions.

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"FASB-CASB—SIMILARITIES AND DIFFERENCES," Howard W. Wright, FINANCIAL EXECUTIVE, Volume XLI, No. 9, September 1973.

As a part-time, paid consultant to the Cost Accounting Standards Board (CASB), Howard Wright is obviously well qualified to present his views of the CASB. Unfortunately, the reader immediately gets the impression that Mr. Wright's purpose is criticism of the CASB and the five standards it has promulgated. A possible reason for his biased opinion becomes apparent when the article is taken in context with another article, "CASB†—Past, Present and Future" by Arthur Schoenhaut, presented in the same issue of the *Financial Executive*.

Schoenhaut, the executive secretary of the CASB, states that this body had to be created to fill the void produced by the ineffectiveness of Section 15 of ASPR. The article also mentions that Mr. Wright was the author of Part 2, Section 15 of ASPB and was opposed to the creation of the CASB. Mr. Schoenhaut's article was apparently printed as a rebuttal to Mr. Wright's highly critical opinions.

After analyzing the five standards presented by the CASB, Mr. Wright reviews future problems which are to be considered by the Board and gives his personal opinions on them. The Financial Accounting Standards Board (FASB) cannot yet be evaluated, he states, since it has been organized only recently. Although he suggests that the FASB might seem to be only a continuation of the old Accounting Principles Board, the potential exists for much better results.

In comparing the organizational structure of the two Boards, the author is again critical of the CASB for its heavy reliance upon staff members for research, for its short working sessions, and for the pro-government background of many of its personnel. In contrast, he believes that the FASB has a more practical organizational make-up, consisting as it does of full-time members not subjected to possibly conflicting outside influences and interests.

The main differences between the two boards result from the differences in their purposes. The CASB is a creature of government and politics, designed to specify the rules under which contract payments are made by the government. The FASB is a creature of private industry, designed to sharpen rules concerning accounting practice, primarily for the benefit of the investor.

Mr. Wright hopes that the FASB will be an improvement over the old Accounting Principles Board. The potential of its members, its financial backing, and its widespread support by the profession are all indicators that the FASB will be a success. If it is not, the author believes the government will promulgate accounting rules in the future. Although somewhat different in purpose, the two Boards can and should work together in Mr. Wright's opinion to solve problems, avoid confrontations, and prevent duplication of effort. This is the most constructive idea presented by the article. If the accounting profession is to advance in its ideas and practices, then mutual cooperation and good judgment among its members must prevail.

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Answer: b. $4,000.

Cash rent for six months	$6,000
20,000 gain ÷ 10 (six month periods)	2,000
	$4,000

(See APB Opinion #5)[1]

13. The auditor's report covering the December 31, 1971, financial statements of Wald Corporation was qualified due to a legal suit pending against Wald. The suit was settled on June 30, 1972, and Wald was required to make payments of $40,000 per month for 20 months beginning January 1, 1973. The discounted present value of the future payments at June 30, 1972, and December 31, 1972, was $790,000 and $792,000, respectively. The charge against revenues for the year ended December 31, 1972, resulting from the settlement of the legal suit was

a. $792,000.
b. $800,000.
c. $0.
d. $790,000.

Answer: c. $0.
There would be no charge against revenue in 1972, the liability would be shown on the balance sheet.

14. Sanitate Company issued 200 7% bonds for $200,000. Each $1,000 bond carries two stock warrants. Each warrant grants an option to purchase one share of $85 par value common stock at $110 per share before December 31, 1973. At the date of the bond issue Sanitate's common stock is selling for $100 per share and the warrants sold for $10 each. The credit for the warrants that Sanitate should record at the date of issue is

a. $3,636.
b. $0.
c. $2,000.
d. $4,000.

Answer: d. $4,000.
400 warrants x 10 (selling price) = $4,000.
$4,000. would be shown as Stock Warrants Outstanding
(See Welsch[3], page 782)

15. Based on the same facts as described in item 14, if 95% of the warrants are exercised prior to December 31, 1973, the total "capital in excess of par" created by the sale of the related common stock would be

a. $10,880.
b. $9,500.
c. $3,800.
d. $13,300.

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Editor's Notes

Our original plan for these Editor's Notes was to give you a short account of our January trip to Europe. Many of you expressed an interest in the venture at the Joint Annual Meeting in Atlanta last October and hoped that our two sponsoring societies would organize such a trip in the future. So we thought we would tell you briefly how it went. But the short account became longer and longer, until we finally turned for help to our co-director of the trip, Dr. Mary Lou Bryant. The result is the article "If It's Monday, This Must Be Touche Ross" earlier in this issue.

A New Department

With this issue we inaugurate another new department, namely *Personal Management.* Its editor is Jean E. Krieger, CPA. She is a senior tax specialist with Haskins & Sells and a member of both ASWA and AWSCPA.

In her first column Ms. Krieger mentions some of the topics she plans to discuss in future issues. If you would like her to cover other subjects that are of special concern to you, do write to her directly — or write us a Letter to the Editor. The same goes for all the other departments.

In addition to subjects you would like to have discussed, we would also welcome some feedback on the technical level you want for these columns. This is especially important to the editors of the Tax Forum and the EDP Department where the level of expertise among accountants varies greatly. Are you a specialist in an area who wants highly technical information? Or do you have only a nodding acquaintance with the subject and want to learn about the basics, such as what is the difference between COBOL and FORTRAN? Without guidance from you we will cover the subjects we think will be of interest to you. We will also vary the technical level, so that some columns will be rather sophisticated, whereas others will be more basic. Please let us know whether you agree with this policy. After all, this is your journal.

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Answer: d. $13,300.
Warrants exercised 400 x 95% = 380 warrants

Option price of share	$110
Value of warrant at time of issue	10
	$120
Par value of stock	85
"Capital in excess of par"	$ 35

380 warrants exercised x $35 = $13,300

Footnotes

[1] Commerce Clearing House, Inc., *APB Accounting Principles as of June 30, 1973,* Volume Two, 1973

[2] James A. Gentry, Jr. and Glenn L. Johnson, *Finney & Miller's Principles of Accounting Advanced,* sixth edition (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1971).

[3] Glenn A. Welsch, Charles T. Zlatkovich, and John Arch White, *Intermediate Accounting,* third edition (Homewood, Illinois: Richard D. Irwin, Inc. 1972).

London Financial District