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October, 1977 Volume 39, No. 4

CONTENTS

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Editor's Notes

Voyager I spacecraft is rushing toward Jupiter, enroute to Saturn, eventually to leave the solar system and slice into mid-galaxy. Unlike the new space shuttle with its potential for linking space and industry in a technological revolution, Voyager's mission is pure research and speculation. When its reporting duties are done it will carry into outer space a recording of earth sounds on the outside chance that someone, something, out there will capture that copper record and hear American jazz, Oriental music, and Beethoven's "Fifth Symphony" along with an aria from Mozart's "The Magic Flute," and other selections. Included are the mooing, barks, roars, and squeaks of some two dozen animals as well as the noise of trains and planes and even an earthquake.

It is a long distance; the chance that it will be retrieved by intelligent life out there is a very long shot indeed. Voyager I is the stuff of dreams.

What if Voyager were carrying the accounting story along with all those other Earth sounds?

There was a first time for each of us when the accounting equation appeared on some classroom chalkboard. If a niece or younger sister were to ask, now, "What is accounting?", A=L+E would still be a valid distillation, but suppose the questioner were someone from another culture, say, from a communist economy, or a young person from India or the savannas of Africa? Exotic space creatures would scarcely present more communications problems.

To begin with, whose accounting should be explained? North American generally accepted accounting principles aren't so generally acceptable in Vladivostok or Nairobi. Accounting, as everyone knows, is the language of business — but whose business? If capital is not understood as a basic factor of production then the accounting equation does not translate freely; if proprietary skill is unknown or unrewarded then the idea of profits is as remote as the far constellations.

For that matter, enthusiasm for accounting principles is seldom unanimous even in the very country of their origin. Not everyone saw FASB Statement No. 8 as a radiance to be acclaimed with joyful hosanna.

Internal dissent can be healthy. It implies a certain sophistication on the part of business. while emerging nations, on the other hand, are vulnerable to all the risks attending naivete. Nearly untutored as to methods of economic development they must, nevertheless, make some choice for an accounting ethos and it is easy to understand if their choice is for agreement with the prevalent developer. The developer will of course promulgate the practices of the sponsoring nation, whether or not they are in the best interests of the emergent, or even compatible with the local culture. Missionaries who saved Hawaii from paganism in the last century promptly cloaked the magnificent nude innocence of each native with a drab mu-mu. It would be surprising if there were not some accounting mu-mus flapping about now in India and Africa and South America. And it is standard missionary procedure to shield new converts from all competing cults of external source, and to quell any native questioning of the revealed truth. Emerging nations present the accounting profession with a remarkable opportunity to rise above that arrogant missionary tradition.

The year may well be one of the far reach, both in outer space and within the world of accounting. This month of October will likely see the formation of the International Federation of Accountants (IFAC) when representatives of some seventy-three nations attend the eleventh International Congress of Accountants in Munich, Germany. The AICPA is one of about forty organizations who have already indicated their support of the proposed federation. It can be assumed that meetings on all three days will reflect the theme of the first plenary session: "Harmonisation of accounting and auditing practice in the last five years." The proposed IFAC would work toward "a coordinated worldwide accounting profession with harmonized standards." (Farewell to the zealots of special accounting groups.)

Such authority as the federation might attain eventually could only be with the consent of the governed and that would mean some yielding of power by autonomous groups such as the AICPA. It is an iffy prospect, although the chances are presumably better than the odds on Voyager's recording of earth sounds actually being heard by someone, something, someday long hence out in the galaxy.

The Woman CPA salutes the occasion of the eleventh International Congress of Accountants with a series of three articles. Two of our regular columnists have contributed their insights into world-wide accounting activity, and the third article by a student member of ASWA explores the growth and impetus of the movement toward international accounting standards.

We are earthbound; it is our nature. But it is also the nature of humankind to try something new in the hope that it will lead to some better way. Voyager spacecraft is our furthermost fling but if accountants in the many nations of planet Earth can achieve "harmonisation," isn't that, in its own way, a reach for a star?

Constance T. Barcelona

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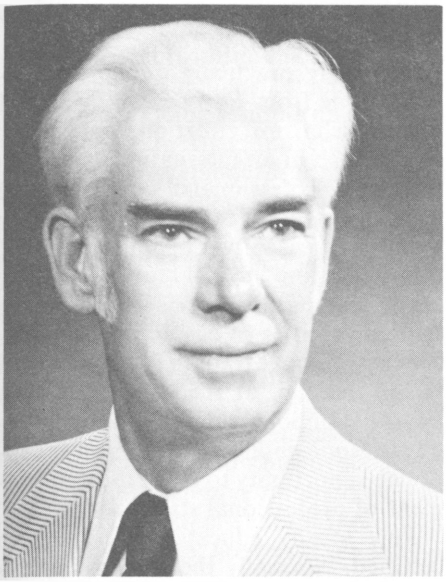
Accounting in the Third World



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Politicians from King Tutankhamen to the Democratic party have been prone to attribute national greatness solely to their guidance. Kings, queens and imperial presidencies notwithstanding, if the native topsoil is fertile or covers rich mineral deposits below, if the climate and terrain are conducive to activity and if labor power is available, then the country is almost bound to become productive assuming that business acumen also is present, either indigenously or imported. If the productivity is channeled to serve the interests of the natives rather than exploit them, then the nation will be propelled into a happy economic condition. Emerging nations of the Third World have discovered that they must develop native business expertise to augment their vigorous patriotic fervor.

The study of history supports the thesis that the rate of growth and the development of a nation's economy in both the private and public sectors depend heavily upon the adequacy of the accounting information system. Emerging nations are in different stages of economic development and have cultural, social, political, and economic differences, yet all seem to have common goals: political stability, social equity, and economic growth. Their national efforts are directed toward the assumption of their rightful place among industrial nations. To realize these goals they must develop an industrial economy to help provide jobs for the growing populations, eliminate unemployment, and provide an abundance of consumer goods, all of which requires capital, and technical knowhow. Capital suppliers must have confidence that the funds supplied will be properly used.

Developing nations believe that industrialization can be achieved in a time span of from ten to twenty years as compared to eighty to one hundred years in Europe and forty to fifty years in the United States. The shorter time projection is due to (1) shared technology, (2) the availability of capital from sources such as the World Bank (3) the movement of international corporations into all parts of the world, and (4) international cooperation in education and training. A typical economic development plan may seek to make a country self-sufficient in certain specified areas. The January 26, 1975 *New York Times* reported that it is one goal of Nigeria's five-year-plan, started in April, 1975, to make that country self-sufficient in the production of petroleum products, petro-chemicals, and paper.

The following discussion examines the relationship between some of the problems of emerging nations, the underutilization of managerial accounting techniques, and the lack of adequate measurement and reporting standards. It focuses on African nations, but all developing countries share many common goals and problems.

Environmental Influences

Are the emerging nation's dreams of radical economic transformations realistic? Can the citizens achieve political stability and social equity as they seek to throw off the specter of colonialism? How acute is the shortage of technology, capital, and manpower?

The ghost of colonialism haunts Africa as it does many developing countries. For centuries the economy has depended on agriculture and the extraction of natural resources by manual labor. Employers, supervisors and managers were non-African; all of the workers were African and their work attitude reflected their alienation from a sense of common enterprise. Very few of the laborers embraced the work ethic which characterized the United States during its developmental stages. Cultural, educational, and political differences between foreign management and native workers deepened the abyss between them.

Politically, many nations are struggling with the problems involved with obtaining freedom from the motherland. Business enterprises facing personnel, cost, and location decisions are influenced by the legacies of colonial policies. Few Africans have been trained to possess the necessary political skills to lead their nations. Rhodesia, for instance, a country with a relatively advanced economy, faces the possibility of political upheaval with the approach of black rule. An unstable political environment and the potential for unrest within the native population tend to discourage new capital commitments and in some cases companies are withdrawing from fear of nationalization under new regimes.

The cultural environment offers more promise of stability than does the political scene. Here tradition plays a decisive role. Tribal customs reinforce loyalty among family groups while an awakening sense of common heritage is influencing cooperation between tribes and regions. However, in some countries ethnic, language and leadership differences impede national progress and add to the political unrest. Business languages are usually those of the motherland but few workers have any language skills other than their tribal dialects, which differ from riverbank to forest.

The father-to-son pattern for transferring skills does not exist because few of the fathers have occupational skills to teach. To insure an adequate supply of skilled craftsmen, typical five-year plans give top priority to technical education. Great emphasis is given to the geographical distribution of students in professional disciplines but accounting education is not mentioned in the Nigerian plan.[1]

Education is dominated by the traditions of the colonists. Top students, after careful screening, are often sent to the motherland for their education and training. However, educational policies are changing and many students come to the United States for training now. Various countries also have American sponsored programs directed by professors on leave of absence from American colleges. Iran's Center for Management Studies is headed by a professor on a two-year leave of absence from Harvard's Graduate School of Business Administration. But although American thought is influencing education in the emerging countries the technical practices are still European. The Continental pattern is especially true in accounting.

Religion plays an important role in the social and cultural environment of Africa where Muslims constitute approximately one-half of the religious population. Large numbers of Protestants, and Roman and Eastern Orthodox Catholics, testify to the efforts of Christian missionaries also, but their current attempts at conversion are meeting a new sense of ethnic and cultural pride which allows only limited success. Burgeoning pride in heritage may conceivably link Christian culture with the technical innovations of more industrialized nations, and reject both the ethnic and the expertise. Coming decades may see indigenous pride, which often includes resentment toward those seeking to change customs and practices, overshadow the desire for the benefits of industrialization. The followers of Islam will play an important role in many developing countries; their traditions and philosophies must be a major consideration in formulating economic policies.

Historically, ownership of businesses in Africa has been the province of European interests. American money and management have made a significant impact only in the last few decades. Legal environments within nations differ but emerging nations are moving to assure that majority ownership in businesses is held by nationals. Supported by indigenous decrees the small business owners will become a more important force in the economy in the future, and must assume more responsibility. Present economies are a mixture of free-enterprise and government control with international interests controlling most imports and exports.

Small businesses tend to engage in wholesale or retail marketing, and mining. An acute shortage of consumer goods reflects the lack of extensive manufacturing. Personnel shortages in all occupations needing technical training are critical, especially in accounting. Many small businesses do not even keep records and few persons possess even elementary bookkeeping skills. Rare, indeed, is the person with an accounting education.

Accounting Characteristics

In many developing countries accounting does not occupy a position of importance. In the public view it has not risen above the level of bookkeeping, and where audits are required they are considered a nuisance.

An officer of one of the leading banks in Nigeria reported to Gbenedio "most of our customers are petty traders and retailers who have practically no need to consult a public accountant. The majority of them do not keep accounts for their business. . ." The taxing systems do not require extensive records. (Many small businesses in the United States kept no records until the passage of the personal income tax law.)

Public accounting is in its infancy in many developing nations. None have a strong professional body to which government authorities, organizations, industry and commerce, and the general public can come for advice and assistance. In some countries the public arm of the profession does have legal recognition and has the power to control professional certification and entry to the profession.

The early practicing public accountants came from Europe. Many stayed to establish firms, either on their own or as a branch of an international accounting firm. Professional organization and practices follow that of the mother country — usually England. It is not unusual to find three or more of the "Big Eight" international firms with offices in the major cities of developing nations. These firms have the potential to control the profession; at the same time that potential imposes upon them a tremendous responsibility and offers an exceptional opportunity to guide the development of professional standards.

Few locally educated Africans are certified. Normally the students studying abroad take the certifying examinations in those countries. That procedure, coupled with the immigration of persons holding certificates from other countries, supplies the majority of the new public accountants. Only a few applicants whose education is limited to native schooling have met the required standards in those countries that have established examination procedures. Gbenedio reports that in the first six years that it was administered only eight persons passed the Nigerian examinations for Chartered Accountant. He believes that the high failure rate is due to the fact that the content of the examination relied so heavily on the British counterpart which presupposes the presence of comparable instruction.

Successful local firms tend to merge with international firms who primarily serve the needs of the larger organizations. Small business has scant access to the services of public accounting, and nationalization of the profession has barely begun.

Until recent years accounting was taught only in the major universities. This situation is changing as other colleges are adding accounting courses to their curricula. However, except in a few schools, the course contents have not advanced beyond the stage of bookkeeping. The quality of instruction is poor. Instructors are poorly educated, poorly paid, and must supplement their teaching salaries with other full-time employment so that lecture preparation time is limited. Predictably, students leave the classroom ill equipped to meet on-the-job challenges.

Challenges Facing Accounting

The myriad problems facing accounting in developing countries are not unlike those confronting the professional industrialized nations. Each country must find ways of assuring an adequate supply of educated and trained personnel. Quality standards for measuring and reporting economic information must be developed. Users must be educated in the use of financial statements and understand their potentials and limitations.

Present information systems are poorly organized and underdeveloped, with inadequate systems especially prevalent in government agencies and government owned business. Small businesses often have no systems. Few information systems, except those of international firms, approach the level of sophistication expected from public companies in the United States. The financial statements which are prepared are often only those required by law. Ways must be found to insure that relevant information is accumulated and reported in a timely way in a form appropriate for the intended users.

Lack of managerial appreciation of the potential contributions of accounting is typical of the Third World. Executives usually are not aware of the purposes and importance of the information gathering and reporting systems. Neither are they aware of the skills of accountants and they fail to perceive the accountant as a financial expert whose skills can be used in helping to solve managerial administrative problems. Little emphasis is placed on information intended for use by internal management. One banker in Nigeria reported to Gbenedio that the principal use for financial statements is their submission to banks for commercial loans, and that the statement need not necessarily be taken from the records, but could be projected amounts.

Alleviation of the shortage of persons with accounting skills must have top priority. The physical capacity of current college end technical school accounting programs is not large enough to meet current and future demands, and there are not enough qualified practitioners to attempt extensive on-the-job training. Future training will depend on a combination of academic and practical training. But, other pressing educational problems must be solved before increasing the actual numbers in educational programs.

In the next decade higher education must improve current programs. Institutions should give preference to the better preparation of students to meet the demands placed on accounting personnel. Research by the AAA Committee on Accounting in Developing Countries classified the major educational problems according to importance. Those listed as extremely important are:[2]

1. Inadequacy of locally authored textbooks. Local accountants most qualified to write are too busy to do so.
2. Inadequate teaching of accounting subjects at the college level. Accounting instructors must hold several jobs to supplement their teaching salaries.
3. Lack of qualified instructors at the college level. There is a general shortage of accountants and educators.
4. Lack of professional development opportunities for accounting educators and practitioners.
5. Inadequate accounting education for managers and prospective managers.

The developing countries are not alone in their search for acceptable procedures for establishing and enforcing accounting and auditing standards. There has been no legislative action on such standards. The absence of any counterpart to the Securities and Exchange Commission to spur standard development is keenly felt. The search for accounting principles and standards in the United States can serve as an example of how *not* to approach it! At least American accountants have learned that no one sector of the profession can set standards and expect them to be followed by the other sectors. There must be unity among those chosen to develop standards and those who apply the standards. Professional associations should share the responsibility in developing accounting principles and standards.

The accounting profession in developing nations includes persons with different specialties. There is generally a national organization made of several associations of person organized along the lines of specialties. Unlike America the "institute" may be composed of members of various groups including public, cost, managerial and government accountants. The association may be legally charged with the duties of regulating and controlling public accounting. Cooperation among the groups is imperative since a young and developing nation can ill-afford the folly of a divided accounting profession.

Conclusion

The problems faced by the accounting profession in the developing countries are great but not insurmountable. The needs are recognized by the accounting profession in America. Some accountants have joined the Peace Corps and volunteered for assignments in developing countries. This is the right time for accountants to project themselves as a positive force in solving problems in the developing nations. However, accountants must be keenly aware that any program arbitrarily prescribed must be feasible and culturally compatible in the particular country.

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[1]Pender Okpako Gbenedio, "The Challenge To The Accounting Profession In A Developing Country: The Nigerian Case" (unpublished Ph.D. dissertation, The University of Cincinnati, August, 1977), p.1

[2]American Accounting Association Committee Reports, 1976, *Accounting Review*, (Supplement to Vol. XLXI, 1976), pp 198-212

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Terrestial Accounting for Extraterrestial Readers

Ula K. Motekat, CPA, DBA

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Dear Reader in Outer Space:

A package from planet Earth is on its way to you via Jupiter and Saturn to tell you about life here. But if you try to visualize activities on planet Earth based on the sounds and pictures recorded in our Voyager spacecraft you will get an incomplete image.

For instance, you are being sent various pictures and diagrams coded in electronic impulses but you are not given two of the most important mathematical equations here on Earth: (1), assets = liabilities + equity, and (2), revenues - expenses = profits. And although you are getting some Earth music nobody is telling you that debits and credits are the keys in which a lot of music is written, namely the music of business like the jangling of coins and the ringing of cash register. To expand the impression conveyed by the Voyager package we are sending you this letter to tell you about accounting here on Earth.

First of all, you should know that accounting is called the language of business. However, we do not all speak the same language here on earth and we are counting on your super intellect to understand our own English. Each of the multitude of other languages spoken and written here on Earth reflects the historical and cultural development of the people who use it, just as each nation's accounting principles and practices reflect and reveal the economic development of that nation within its history and culture pattern. In fact, you can understand a country's accounting better if you know something about its history. Since this is only a letter and not a multi-volume history of the world we can only give you some examples.

The United States, for instance, was settled mostly by people who were dissatisfied with the status quo in their countries of origin. They came to the New World to start a new life. Here they found that everything is bigger and that individual success is possible, even if the streets are not paved with gold. (Gold is a precious metal here on Earth, more precious on some days than on others but that is a phenomenon beyond the scope of this letter.) The conventional wisdom evolved in this country is that new is good, bigger is better, and success is measured in dollars. And when it comes to measuring dollars an accountant is needed.

So picture the American accountant who found that public adulation (usually accompanied by lots of dollars) went to people who saw a need and invented something, if only a mousetrap, to satisfy that need. Can you blame the accountants for wanting to do their share, and then share in the rewards? Since they did not know how to invent the proverbial better mousetrap they just elaborated on their own accounting principles and practices. (And since status in the business world went to companies with steadily rising earnings, their accountants devised some decorative reporting methods. However, we can't discuss them because they are closely-held trade — pardon us, professional — secrets.)

Just think, if there are two alternatives to each of ten accounting problems (such as the valuation of inventories and other assets, depreciation methods, or accrual of pension liabilities) then there are 2^{10}, or 1,024 possible ways to prepare the financial statements for any company that has all ten accounting situations. In practice, there are often more than two acceptable methods for a specific accounting problem. It is obvious that many, many accountants are needed to prepare all those statements and to evaluate the advantages and disadvantages of each, and to do that each and every year. In a nutshell, it can be said that American accounting, like American life, is characterized by individuality, innovation and variety.

That is not as true of another English speaking country, namely the United Kingdom, where the people and the accountants value tradition. Would you believe that they adhere to a tradition even if, according to the apocryphal story, it is based on a printer's error? The proof is their balance sheet. They put the debits on the window side, like any society that has seen the light, but they usually depart from international custom and list the liabilities and equities on the left side and the assets on the right side. Legend has it that in the last century a printer made a mistake and reversed the two pages of an illustrative balance sheet when one of the Companies Acts was put on the printing press, so with typically English imperturbability accountants since they have seldom seen fit to change the form.

Innovation occasionally does play a role in British accounting, but it is limited because practitioners always check new accounting methods with an incorporeal arbiter they call "One." You see, in Britain there are things One doesn't do, and things One does do. One doesn't, for instance, depreciate most buildings because they appreciate faster than they depreciate. It is entirely possible that One doesn't do it because book depreciation is not deductible for tax purposes. Instead, British businesses receive a capital allowance from Parliament each year, although not for most buildings.

Since buildings are not depreciable for tax purposes and since they tend to appreciate, especially in times of inflation, One does write them up in the balance sheet. But because One hasn't developed as yet the One way of computing a building's current value, One can use various values like current value under present usage, or current value under most profitable usage, or current replacement cost determined from a specific price index, if available, if One wishes to follow the recommendations of the Sandilands report. However, even in Britain there are people who, with sufficient incentive, do what One doesn't do and some of those people apparently have been accountants. Therefore an Anglo-Saxon maxim has evolved that says: You are less likely to do something One doesn't do if you have to tell the world about it. Translated into accounting jargon that means: Disclosure in the statements.

The British Companies Acts don't tell accountants how to account, but they do tell companies to disclose how their accounting is done and how much they pay their auditors to help them with all the disclosure. For that reason a British income statement may not be an income statement in the American sense. In the United States the income statement starts out with gross revenues and arrives, after a series of subtractions and additions, at net income. In England the statement may be just a list of items which must be disclosed, like gross sales, total depreciation, renumeration of auditors and of directors, and net income. If a tendency toward forthrightness becomes overwhelming then the British accountant may lump all the items that are exempt from disclosure requirements, and present them in one catch-all line under "all other costs and expenses."

On the other side of the English Channel, accounting is influenced by the French love for logic and for systems. The French took the whole of accounting and put it into one logical system which they call the Plan Comptable. It is based on the decimal system and assigns numbers to every conceivable account. Assets, for instance, belong in Group 2; fixed assets are in subgroup 21, and buildings are 212 when they are finished but subgroup 23 while under construction. The Plan Comptable also tells what accounts to debit and credit, and for the end of the accounting period it prescribes a set of financial statements in which account balances are entered on the lines identified by account numbers. Voila! The Plan Comptable is used by most business enterprises in France, either because it is such a logical system, or because the business received (or hopes to receive) money from the government. In the event of government subsidy the business is required to use Plan Comptable accounting.

On the other side of the Rhine the Germans developed their own system of accounts which, given their penchant for long words, they call the Industriekontenrahmen. For some reason (which may have something to do with the fact that stock ownership is not widely dispersed) they don't like the word profit but they do like the term balance sheet. Therefore they invented various words, usually long, so that profits can be described without ever really mentioning the word. They have a Leistungsbilanz (achievement balance sheet), a Bewegungsbilanz (movement balance sheet) and an Erfolgsbilanz (success balance sheet), and if all of these are too short for a truly satisfying accounting experience they have available an even more magnificent title. Consider the feeling of fulfillment for the accountant who prepares the Erfolgsermittlungsbilanz (success determination balance sheet).

Eastern European people want to make money just like people in capitalist countries. But without profits how is success or failure measured?...well, something else is measured that can be expressed in numbers.

Inspired by their love for order the Germans developed their own principles of orderly accounting, and one of them got them into trouble. In the United States it was realized early on that financial statements perform a different function from tax returns. In America one thing often can be done on the income statement and something else can be done on the tax return. German accountants developed the principle that their books determine the tax return, and now they are stuck with it. In order to get a deduction on their tax returns they must record the deductible expense on their books. Consequently, book values and depreciation are what the tax law allows. And since German business, like business everywhere, exerts pressure on its legislature to grant liberal deductions, German book values bear even less relationship to current

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Women Accountants In Other Countries

It is possible that the political atmosphere in some of the nations may be a deterrent to women entering a career in which men predominate. It is a fact that in some countries women still do not have the right to vote or this right is restricted in some manner. Even in countries where women do have equal political rights, some of the obstacles that seem to hinder women from exercising them are the apathy of the women themselves, traditional attitudes and customs, tendency of women to confine themselves to social work, the diffidence of many women to assume responsibility — which tends to discourage them from full participation in public life — and the multiplicity of tasks women are frequently called upon to assume. Education is a most important factor in making women aware of their rights and responsibilities and encouraging them to play a more active role.[22]

Although almost all the nations reporting indicating women have an equal opportunity to enter the accounting profession and educational facilities are available to them, women in other countries seem hesitant to participate in the usually highly respected profession of accountancy. Coeducation at all levels may help to overcome this hesitancy.

[22]*Newsletter on the Status of Women, Number 40, June 1970, Political Rights of Women, Page 10.*

From an article by Eunice E. Stockman in the July, 1971, issue of the Woman CPA. Ms. Stockman's article was also the source of many of the foreign titles for women accountants that appear in the current issue.

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values than do American book values.

Mediterranean travel is fun under our sun but for further discussion of accounting it is practical to stay north of the Alps because there really is no such thing as Italian accounting. In Italy the board of directors has the right to determine accounting methods for each company, completely unhampered by such restrictions as consistency and disclosure. A rivederci, Italia.

Eyes to the east instead, for a look at socialist accounting. As practiced in Eastern Europe, accounting is understandably influenced by Communist ideology. That means profits are out. However, costs are still in, and people there want to make money just like people in capitalist economies. But without profits how is success or failure measured; how can one state enterprise be compared with another? Well, something else is measured that can be expressed in numbers. And that can lead to totally unintended results.

For instance, the success of a state agricultural enterprise may be measured in tons of food produced compared to the cost of production. Now any farmer knows that some crops use more labor per pound of food production than do others. And if the farmer also knows anything about accounting it is apparent that less labor means lower production costs. Is it any wonder that cabbages are plentiful, tomatoes are scarce, and peas are a rare delicacy?

Agriculture provides Eastern European accountants with a certain advantage. They don't have to specify what the end product looks like because most people can tell an apple or a cauliflower when they see one. Industrial production is a different story, however. The industrialist must provide a specific description of how a widget is to be made, what is to go into it in terms of labor and materials, and what the widget is supposed to look like when it is finished. (Widgets are amorphous, or speedily metamorphosing, products reputed to be made by all industries but most usually visible to the faculty of North American schools of business administration.) An Eastern European widget tycoon must prepare a detailed blueprint which includes specifications as to the kind and amount of labor and materials necessary for the fabrication of one widget. The widget factory is then told how many widgets to produce and is given (at least theoretically) the exact kind and amount of labor and materials needed to meet its production goal.

However, managers — and with increasing frequency, the workers — are rewarded for exceeding that goal even though they are not initially supplied with any more labor or materials. The incentive system encourages them to produce more widgets but use less labor and material for each. In other words, they may use two screws instead of the prescribed three screws to hold the parts together, and as a labor saving strategy they may tighten the screws with only a token turn.

Predictably, the widget factory described above will exceed its production goal of units of output by many percentage points, and its work force will be rewarded handsomely. Of course none of the widgets will work well, or if by chance a few do, they will soon fall apart. But that is no problem in Eastern Europe. First of all, widgets are presumably scarce so people are happy to get them even if they have loose screws (the widgets, not the customers). Secondly, all widgets look the same so it is difficult to identify a widget with a particular factory. And lastly, if the origin of the defective widget should be discovered there is no complaint department in that factory where the aggrieved buyer can pound the table and ask for a refund for the missing screws.

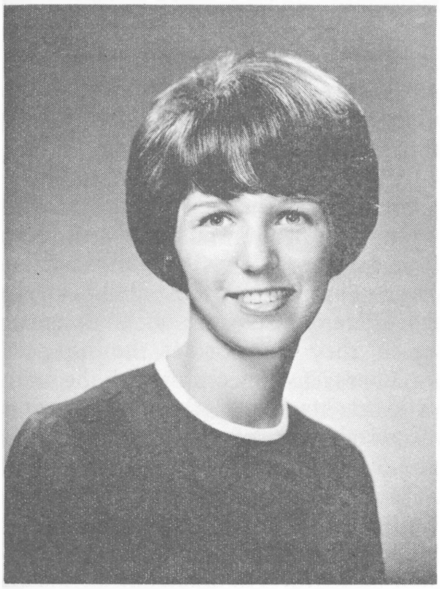
Socialist accounting invites more discussion but it would delay the full globe inspection of accounting practices on planet Earth. There is just time to take a quick look at Japan and to notice that the Japanese have extended to accounting their talent for adopting foreign ideas and adapting them to their needs. Japanese accounting is, by and large, an adaptation of North American accounting.

Earth sounds captured on the record in the Voyager spacecraft will stimulate your hearing senses (ears?). This letter will signal to your visual facility (eyes?) and be translated by your super perception into some image of accounting in our world. We admit to oversimplification but we hope we have conveyed some idea of the varied types of accounting, and their importance. We don't pretend that life here on earth would be impossible without accounting, but we do claim that if you want to measure the accomplishments of a business over time, accounting is an indispensable tool.

With our best earthy regards,

Debit and Credit
Accountants on Earth.

The Development of International Accounting Standards



Jan Giannini Brown

Jan Giannini Brown is a staff accountant with Peat, Marwick, Mitchell & Co. at Syracuse, New York. The following article originated while she was a student member of American Society of Women Accountants at the Memphis Chapter. Ms. Brown did her undergraduate study at the University of Wisconsin and received her graduate degree of MS in accountancy from Memphis State University.

"International accounting...is not a separate subdiscipline of the subject (of accounting) but rather practiced by various nations in their efforts to control and direct the activities of their particular business communities. Achieving any measure of harmonization among these diverse accounting practices requires altering either the business practices or the political thrust of the national system. Accounting is accounting; its proper application is the crux of the international problem."[1]

Legal framework and institutions, as well as local politics, have dominated the growth of the accounting profession in many countries. As a result there is wide variation in "generally accepted accounting principles." This paper examines the international accounting environment and the search for international accounting standards.

The Problem

Accounting has developed at various rates throughout the world. It reflects not only differing stages of economic development but also many political influences, government regulations, and development or non-development of professional accounting organizations. According to Australia's Dr. Raymond Chambers, accounting is the same throughout the world; its function of communicating and analyzing financial data is universal.[2]

But there are problems in international accounting. They stem from the external political and legal constraints which distort the function of accounting to serve other interests. Efforts to harmonize accounting standards are hindered by these constraints. National professional organizations are also reluctant to give up sovereignty over their jurisdictions.

There are those who believe the attempts to achieve a degree of uniformity in international accounting are unnecessary and/or impractical. Some contend that standards in the United States are superior to those of other countries, that attempts to achieve international standards conflict with the work of the Financial Accounting Standards Board, and that implementing international accounting standards may be impractical since the FASB has the dominant power of establishing U.S. accounting standards. Doubtless, similar arguments by other national interests have similar application in other countries.

Proponents of international accounting standards argue that international accounting standards will help investors in multinational corporations and help the multinationals to take advantage of foreign securities markets because financial statements will be more comparable. In an age when multinational investing is a daily occurrence the development of international accounting standards is essential and long overdue.

Accounting in Various Countries

It is enlightening to look briefly at accounting as it exists in various countries.[3] At once the problem of international accounting becomes more than one of accounting for foreign currency translation, although that is undeniably a major concern.

Germany

The approach in setting German accounting standards is strictly legalistic and standards are set by politicians. Tax regulation requires that tax deductions also be deductions in financial reports. Deferred charges are excluded from assets. Income or loss is the difference between net assets at the beginning and end of a period, adjusting for withdrawals and capital contributions. German accounting standards provide convenient opportunities for the management of income.

Mexico

There is one national accounting association, the Mexican Institute of Public Accountants, which sets uniform professional guidelines. Although inflation has been rampant in the past few years, price-level accounting is accorded little or no consideration. Upward revaluation of fixed assets, however, is acceptable. Depreciation is taken on the increased amount of fixed assets.

The International Accounting Standards Committee..."a most promising development"

Preparation of consolidated financial statements is rare.

British Isles

As a result of some notorious instances of aberrations in accounting practices from company to company, the Accounting Standards Steering Committee (ASSC) was established in 1969 and has issued six Accounting Standards. This organization has been given the full support of the stock exchange council.

Canada

The Canadian Institute of Chartered Accountants (CICA) Accounting and Auditing Research Committee and its successors have the right to publish "Recommendations" in the CICA Handbook. These Recommendations must be complied with and any departures must be disclosed and justified.

France

There are many types of professional accountants, each with separate directives. Accounting is regulated more by law — commercial, tax, and other bodies — than by the profession. Most accounting principles are similar to those of the United States. However, financial statements issued to shareholders and those incorporated in tax reports must be in basic agreement. Bad debts must be identified before being written off. Income tax allocation is nonexistent. Footnotes are rare but are being encouraged.

Egypt

Objectives of the Egyptian uniform system of accounting are to facilitate national planning and control, permit the screening of inefficient enterprises and provide information for management.[4]

These six glimpses, although brief, highlight some of the areas of national differences, and underscore the observation in a summary discussion of Accounting Principles Board Statement No. 4, Chapter 9, as amended:..."prerequisite to the development of accounting standards on an international scale is...a knowledge of accounting practices and principles in various countries."[5]

Geographically Related Organizations

In recognition that alternatives in accounting practice must be narrowed, many regional accounting organizations have sprung up. The Inter-American Accounting Conference, the Conference of Asian and Pacific Accountants, and the Union of European Accountants share the objective of furthering understanding among professional accountants in different countries. In addition, the European Economic Community Accountants' Study Group prepares recommendations for harmonizing prevailing accounting practices. Generally, it has accepted the prevailing practices and recommended elaborate disclosures. A true and fair view of a company's financial position and results of operations is emphasized. The Accountants' International Study Group compares accounting and auditing standards in the United Kingdom, the United States, and Canada to promote greater international harmony. The International Committee for Accounting Cooperation assists in the improvement of accounting education and the practice of public accounting in developing countries.

The IASC

The International Coordination Committee for the Accountancy Profession (ICCAP) was formed in 1972 at a meeting of the International Congress. Its purpose is to develop a coordinated worldwide accountancy profession with uniform professional standards. In 1973, the nine-nation International Accounting Standards Committee (IASC), of which the American Institute of Certified Public Accountants is a participant, was formed as an independent arm of the ICCAP. Its purpose is to formulate and publish basic standards to be observed in the presentation of audited accounts and financial statements and to promote their worldwide acceptance and observance.

There are two classes of membership in the IASC. Founding member countries, of which there are nine, have one vote. Exposure drafts require assenting votes of two-thirds of the founding members. Statements of International Accounting Standards require three-fourths assenting votes of the founding members. Associate memberships for institutes are also permitted. These institutes may then nominate individuals for specific assignments and service on working parties.

The IASC determines the topics for possible issuance of standards. As of July, 1977, the IASC has issued, or approved for issuance, seven statements in final form, exposure drafts of five others, a discussion paper on accounting for price changes, and has additional topics under study. (See appendix)

Members of the IASC have agreed to support the IASC standards and to do their best to ensure the published accounts comply with these standards, or that there is disclosure of the extent to which they do not. If the financial statements do not comply with the international standards the audit report should either refer to the disclosure of noncompliance in the financial statements, or state the extent to which the financial statements do not comply. Members have also agreed to assert their best efforts to take appropriate action against auditors who do not comply with IASC standards, and to persuade governments and other authorities as well as the business community that published financial statements should comply with the standards.

Because it is realized that no country would relinquish its sovereignty in setting accounting standards, local standards prevail, but noncompliance with international standards must be disclosed. It is hoped that disclosure of noncompliance will bring pressure on either local accounting organizations or the IASC to change the standard or set new standards.

Gerhard Mueller and Lauren Walker believe "the work of the IASC is without doubt the most promising development ever with respect to setting and achieving a measure of adoption for international accounting standards."[6] So far the IASC Standards have involved areas of minor differences. As the IASC progresses into other areas, many controversies may arise. To meet its objectives, the IASC will need the support of all parties involved.

An International Federation of Accountants has been proposed to replace the ICCAP. Its purpose would be to develop and enhance a coordinated worldwide accounting profession with harmonized standards. It would encourage efforts to establish international technical, ethical and educational guidelines for the accounting profession. The IASC would continue as an independent body and work closely with the new federation. A formal recommendation to establish this body will be made at the International Congress at Munich in October 1977.

U.S. Support For The IASC

The United States has indicated its support of international accounting in general and international standards in particular. In October 1975 the FASB issued Standard No. 8 on Foreign Currency Translation. This Standard requires among other things that foreign exchange translation gains and losses be currently recognized in the income statement.

The AICPA has published a book that describes accounting practices in thirty countries. In addition, the AICPA supports a staff to deal with international accounting problems.

In July 1975 the Institute reaffirmed its support of the IASC and made the following points:

1. To be accepted, IASC Standards will have to be adopted by the FASB.
2. If there is no significant difference between international and U.S. Standards, compliance with U.S. GAAP constitutes compliance with the international standards. Areas of differences should be given early consideration by the FASB to harmonize the differences.
3. Published pronouncements by the IASC will be included in the appropriate volume of AICPA Professional Standards, indicating any significant differences between international and U.S. GAAP.
4. The AICPA will encourage all pertinent parties to respond to IASC exposure drafts.[7]

Conclusion

Different cultures create different standards for comparing financial statements, different investment institutions have different needs, and accounting principles differ from country to country. To deal with these problems, there are three schools of thought: primary and secondary financial statements[8], single domicile reports with limited restatement, and international reporting standards. This paper has dealt with the latter.

The problem is to convey the same message to a foreign user as that received by a native user. Some believe that the dual, primary and secondary system is the most practical approach until the international standards are firmly established.

Ideally, with identical reporting standards, transactions would be recorded the same the world-over. There are many differences to account for and in present accounting practice it often happens that the same event in two different countries will result in two different reports.

It seems appropriate to again quote from Irving L. Fantl who authored the opening quotation: "It were best to harken to the old cliche, to recognize the difference between that which we can improve and that which we cannot change and to change the one while we learn to live with the other."[9]

Editor's Note: Ms. Brown's article deals with financial accounting rather than management, government, or social accounting. It is therefore restricted to a discussion of the measurement and reporting of financial activity of the firm.

"In an age when multinational investing is a daily occurrence the development of international accounting standards is essential, and long overdue."

FOOTNOTES

[1]Irving L. Fantl, "Frustrations Facing Accounting Uniformity," *The Accounting Forum,* (Vol. 46, No. 1, May, 1976), p. 28.

[2]Ibid., p. 27.

[3]"International Accounting Developments: A Symposium,"*The Arthur Andersen Chronicle,* (Volume 34, Number 3, July, 1974), pp. 67-95.

[4]"Report of the American Accounting Association Committee on International Accounting, 1974-75," *The Accounting Review,* (Supplement to Volume XLXI, AAA, 1976), p. 73.

[5]*Professional Standards* Volume 3, Accounting As of Sept. 1, 1975, (Chicago, Illinois: Commerce Clearing House, 1975), paragraph 1029.12, p. 7334.

[6]Gerhard G. Mueller and Lauren M. Walker, "The Coming of Age of Transnational Financial Reporting," *The Journal of Accountancy,* (Volume 142, No. 1, July, 1976), p. 73.

[7]Ibid., pp. 71-73.

[8]Gerhard G. Mueller, "The Dual System for Transnational Financial Reporting," *The Accounting Forum,* (Vol. 46, No. 1, May, 1976), p. 17.

[9]Fantl, op. cit., p. 29.

In Any Language, In Any Country, Business Needs .... The Accountant

APPENDIX

INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE PROGRESS AS OF JULY 1977

Standards Issued

IAS No. 1 Disclosure of Accounting Policies

IAS No. 2 Valuation and Presentation of Inventories in the Context of the Historical Cost System

IAS No. 3 Consolidated Financial Statements

IAS No. 4 Depreciation Accounting

IAS No. 5 Information to Be Disclosed in Financial Statements

IAS No. 6 Accounting Responses to Changing Prices

IAS No. 7 Statement of Changes in Financial Position

Exposure Drafts Issued

E 8 The Treatment in the Income Statement of Unusual Items and Changes in Accounting Estimates and Accounting Policies

E 9 Accounting for Research and Development Costs

E10 Contingencies and Events Occurring After The Balance Sheet Date

E11 Accounting for Foreign Transactions and Translations of Foreign Financial Statements

E12 Accounting for Construction Contracts

Topics Under Study

1. Accounting for Taxes on Income
2. Accounting for Diversified Operations
3. Accounting for Leases in The Financial Statements of Lessors
4. Working Capital
5. Disclosure in Financial Statements of Banks
6. Accounting for Pension Costs and Commitments

The Quipu And Its Uses

Studying counting devices used by ancient people can help illuminate the history of accounting. One of these old devices is the "quipu" which was used by the Inca Indians who inhabited Peru from circa 3000 B.C. to the Spanish Conquest near the middle of the sixteenth century. It is still used in parts of Peru today.

What Is The Quipu?

The quipu, pronounced k e' p oo' means "knot" in the Quichua Indian language. It is a record keeping device consisting of a main cord to which were attached knotted pendent cords by means of strings. The main cord, which was usually of cotton or wool, varied in length from a few inches to more than a yard. After preparing the main cord more strings would be spun to twice the desired length, doubled, twisted together, and looped over the main rope much as a gift tag string is attached to the ribbon, drawn taut, and knotted at the free end. Several strings would be hanging then from the main cord. The number of these strings sometimes exceeded one hundred, but they rarely were more than one-half yard in length.

At this stage, knots would be fixed on the pendent cords. Each of these knots represented a number whose value depended on its distance from the main cord. Therefore, a single overhand knot at the bottom of the string, i.e., farthest from the main cord, represented the unit one, and two knots at the same position represented the unit two.

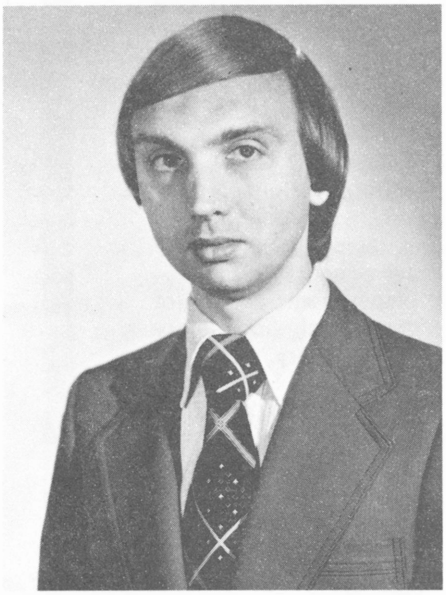
The higher or the closer the position of a knot to the main cord the greater its value. It is of much interest to note that the knots usually were arranged in fairly systematic rows across the quipu so that the unit knot on one cord would fairly approximate the unit knots on the other cords in the quipu. Such placement of knots indicates an early awareness of the decimal system because some spaces were left empty without knots.

Uses of the Quipu;

The skill of preparing and reading the quipu was passed from father to son. It was also studied at the "Teacher House" by youths of the ruling caste in the third year of their four-year course. People who had such skill were called "quipumayus". These record keepers provided information on many areas such as governmental matters or social events like the registration of births, deaths, and marriages. At least four quipumayus were required for each village. The larger the village the more quipumayus were required to live there so that each one could check the work of the others in an ancient form of internal control.

Mohamed Elhadi Bayou
University of Cincinnati

External Audit — Does It Serve The Small Company?



Ollie S. Powers

Ollie S. Powers is Instructor in Accounting at the University of Alabama in Birmingham. He received his B.S. degree from Samford University in Birmingham and holds a M.A. degree in accounting from the University of Alabama at Tuscaloosa.

The role of the public accountant as an auditor has largely been a development of the twentieth century. Although accounting historians make mention of the audit function prior to this time, the early work of the public accountant in the United States was predominantly in the areas of bookkeeping systems, posting, statement preparation and limited examinations for the detection of fraud and errors.

A close relationship can be seen between the development of the audit function and the economic development of the country. Even though by 1900 the United States was one of the world's great manufacturing centers, its economy was still agrarian based with the value of farm products exceeding the value of industrial output. With the twentieth century came the phenomenal growth of American industry, which entailed the development of the corporation as the predominant form of business organization in terms of impact on the economy. As corporations grew larger and more remote from owners, an inherent need for added credibility to financial statements developed. This credibility could be aided by the expression of the opinion of the independent auditor concerning the fairness of presentation of a corporation's financial statements.

The economic growth of this century was not without its problems. Financial abuses, speculation, scandal, panic and monopolistic tendencies marred the early years. With such came the need for legislation and government regulation. Some of the most profound acts of legislation, in terms of their effects on auditing, were the Federal securities acts. Ultimately, the Securities and Exchange Commission was established with its principal objective being the protection of the investor through emphasis upon adequate disclosure. The requirement of financial statements audited by certified public accountants for all companies falling under SEC jurisdiction altered significantly the course of public accounting in America. This says nothing of the effect of the requirement of audited financial statements on the part of numerous other governmental regulatory authorities that have been created during this century.

A Matter of Choice

A publicly held company, meeting the prescribed requirements for registration with the SEC, faces no alternative but to engage the services of an independent certified public accountant in examining its financial statements. The same may be said of companies falling under the regulation of certain other authorities. As a practical matter, irrespective of regulatory bodies, only the smallest of companies generally faces any real decision regarding audited financial statements. Bankers, insurance companies, and significant creditors often make the decision by insisting upon being furnished with audited statements prior to transacting business. In many cases, then, a firm has no available alternative.

It is the small firm, the one that must evaluate and decide upon the desirability of an audit, with which this paper deals. No attempt will be made to define or quantify what is meant by a "small" firm, as such would contribute little and would have no effect upon the statements made herein. As a point of reference, however, a small firm may be thought of as a closely held business, operated by its owner or owners, not subject to control by any of the numerous governmental regulatory authorities and not required by any outsider to provide audited financial statements. The environment is such that each dollar spent is closely enough related to the owner's wealth to require sound justification for all the expenditures. One could ask: Is the cost of an audit not an expense which can be avoided? This question shall be faced by consideration of the advantages and disadvantages of the external audit and its attendant services.

Insight of the Professional

The end-product of an audit is the issuance of the auditor's report on the financial statements of the client. To the proprietor of the small firm, who has very little reservation concerning the financial statements, the auditor's report may be of much less significance than some of the steps followed in arriving at the end-product. For example, early in the examination the auditor must make a study and evaluation of the existing internal control as a basis for his reliance upon the company's accounting records. Among other things, internal control involves the plan of organization and the procedures and records concerned with the safeguarding of assets and the reliability of financial records. Small firms generally are not conducive to the operation of as strong a system of internal control as is possible with a larger firm due, to an inadequate staff for the desired separation of duties and proper system of authorization and documentation. As a result many owners of small businesses attempt to exert their own internal control by "closely over-seeing the entire operation." Of course it is a practical impossibility to examine all transactions unless they are very few in number. In addition, detailed surveillance is less than optimum use of management's time.

It is possible even with a small business to introduce some control procedures and the auditor is in an excellent position to make recommendations. A study of the existing system should point out any weaknesses; suggestions for improved procedures could follow as a normal consequence of auditing expertise.

The intimate relationship that develops between the auditor and client should be emphasized. The examiniation does not entail a mere study of financial statements but delves into the underlying accounting records and operational procedures that gave rise to the accounting records. This investigation coupled with technical competence places the auditor in the position of acting as an adviser to the client, not only with regard to accounting matters but also items indirectly or incidentally related to accounting.

The role of the adviser or consultant can be assumed in several general matters. First of all, informal advice or recommendations may be made from time to time throughout or subsequent to the examination. This is only natural as a result of the close relationship which develops between the auditor and the client.

Secondly, most public accounting firms issue what is commmonly called a management letter at the end of each engagement. Generally this letter to management points out any weaknesses in internal control and accounting or operational procedures. These may have been discussed on an informal basis previously. Serious deficiencies in any of these areas may affect the auditor's ability to render an unqualified opinion.

Many of the items recommended informally or in the management letter may correct relatively apparent weaknesses. However, the owner of the business may have become so involved in the daily operations that the flaws are invisible. An outside party thoroughly familiar with a company often has more insight into needed improvements than one who is preoccupied with the daily routine.

In the course of the auditor's examination, there may become apparent an area, or areas, within the organization that warrant considerable attention. As a result, a formal management consulting contract may be negotiated. Management advisory services have been a rapidly growing facet of the practice of public accounting in recent years. Large public accounting firms have developed management services departments with staffs comprised not only of accountants but also such individuals as industrial engineers, mathematicians, statisticians, data-processing technicians, and wage and salary administrators. Their services include the design and installation of accounting, data-processing, and budget systems; cost and efficiency studies; inventory controls; operational analyses; and financial consultation.

One of the inherent problems of small business is lack of management depth. Only a large firm can justify an internal staff of a size sufficient to include persons with reasonable expertise in the various areas named above. Small firms must either do without such expertise or obtain it externally. The auditor's relationship with his client and his competence in accounting and related areas makes him or his firm the logical source of outside assistance. Familiarity with the client places the auditor a step ahead of any other outsider and, therefore, should make it possible to provide the desired service at minimum cost. Too often a small business owner's function as a "jack of all trades" can lead to serious problems for the company. Outside assistance in areas which demand special abilities may return its initial cost many times.

The Tax Adviser

Any discussion of the services provided by the certified public accountant must certainly turn to tax work. Since first enacted, laws providing for Federal and state income taxes have become increasingly complex to the point that all but the routine individual tax returns require a considerable amount of expertise in preparation. Due to the auditor's familiarity with the client's accounting records and financial affairs, the preparation of the income tax return has become a common extension of the audit engagement. More important than the actual filling in of a form is the contribution which the CPA can make in the area of tax planning. With the Federal income tax rates as significant as they are, the tax impact of many business decisions can be tremendous. Often consideration must be given to the tax effect of a transaction prior to its occurrence to impart the desired effect on the tax return. It is in the planning of transactions that the advice of one highly knowledgeable of the current tax regulations is required. Laws change frequently and are so complicated that only one who works with them regularly can be aware of all that he should in rendering effective tax service.

"...each dollar spent is closely enough related to the owner's wealth to require sound justification for all expenditures."

Of course the certified public accountant is not the only source of tax service. Income tax returns are prepared commercially by a wide range of individuals and firms in terms of quality. The complexity and significance of taxes are such that the small business owner should demand tax work of a professional caliber, both tax return preparation and tax planning advice. Wise counsel on the part of a skilled professional has quite often resulted in tax savings far in excess of the fee charged for such.

The Owner as an Individual

The establishment of a business relationship with a certified public accountant can be of personal advantage to the owner of a small business. The proprietor frequently tends to be the type of individual whose personal affairs are complex enough to warrant professional assistance in administration. Many types of public accounting services rendered to the company have application to the individual owner. Advice on financial matters, tax return

"The smaller the number of employees the greater is the impact on the operation since time spent dealing with the auditor is not time spent in the daily routine of business."

preparation, and tax and estate planning are examples of significant services to individuals. Using the CPA in the business gives the proprietor greater access to regular professional counsel than would likely occur with contacts limited to tax preparation. In conjunction with the services rendered the company the public accountant is able to serve the individual proprietor for a reasonable fee.

The Negative Side

As with any consideration of this type, all is not positive. Probably the principal negative point goes back to the proprietor's concern with the cost of the audit. Admittedly this is a cost which could be avoided. The only response to the concern for cost is that the benefits received, such as those discussed herein, must be evaluated in terms of the related cost. If the owner does not feel that the potential benefits justify the cost, then the conclusion is apparent. However, as has been pointed out, the audit and related services can make a significant contribution to the firm so an evaluation should not be made lightly.

A second disadvantage of an audit is that of inconvenience. By necessity there is a certain amount of disruption caused by the presence of an auditor. The numerous inquiries deter the client's employees from the performance of their duties. The smaller the number of employees the greater is the impact on the operation since time spent dealing with the auditor is time not spent in the daily routine. This disruption is inherent in the process and should not be criticized too severely if, in fact, the end-product is considered desirable by management.

In expressing an unqualified opinion of the client's financial statements, the auditor states that they present fairly financial position, results of operations and changes in financial position in conformity with generally accepted accounting principles. Although the exact meaning of the term "generally accepted accounting principles" may be questioned, the Opinions of the Accounting Principles Board and the Statements of the Financial Accounting Standards Board are recognized as authoritative. To many small businesses strict adherence to some of these pronouncements can be a disadvantage.

Consider for example *APB Opinion No. 11,* entitled "Accounting for Income Taxes." Assume that a small business being audited has several items giving rise to timing difference. Proper disclosure under *Opinion No. 11* can easily result in a lengthy and complicated note to the financial statements. The important question is: What does this note tell the owners of this small business? To them the only really important income tax figure is one showing what will have to be paid for the current year. The elaborate presentation of deferred income taxes and items giving rise to them is likely rather meaningless to anyone less than the highly sophisiticated statement reader.

The object here is not to question the propriety of interperiod income tax allocation. Authoritative bodies within the profession have found it to be consistent with sound accrual accounting. Rather, the point is that there are instances where generally accepted accounting principles, though theoretically sound, may not serve a small bsuiness to the same degree that they serve businesses in general.

Another example can be seen in *APB Opinion No. 15,* "Earnings per Share." Situations are rare where the capital structure of a small company is complex enough to require the reporting of primary and fully diluted earnings per share; significance of such elaboration for a closely held business can be questioned.

Types of Opinions

Limitations in the scope of the audit examiniation, either upon request of the client or the existence of limiting conditions within the organization, may make it necessary to issue a qualified opinion. Or, the exceptions that would qualify the opinion may be so material that an adverse opinion is indicated. Significant scope limitations may also preclude the auditor from obtaining sufficient information upon which to base an opinion. As a result there must be a disclaimer of opinion.

Whenever the auditor issues an adverse opinion on the financial statements as a whole or disclaims an opinion, there is the possibility of issuing a piecemeal opinion. In the case of such, the auditor concludes that, in light of the scope of the examination, there is justification for expressing an opinion that is limited to certain items. Due to the interrelationship of many financial statement items, the significance of a piecemeal opinion in most cases is subject to question.

Anything other than an unqualified opinion generally carries a negative or undesirable connotation. This can be a matter of major concern to the company whose statements are to be used externally. Such companies must be certain that their statements conform to generally accepted accounting principles and must do all possible to enable the auditor to obtain sufficient evidence upon which to base an opinion, regardless of the time and cost involved. This entails some disadvantages to a small company, as previously discussed, disadvantages which may override the desirability of an unqualified opinion.

Since the small company is not concerned with the use of its financial statements by outsiders, it may not be disturbed by the absence of an unqualified opinion. The services attendant to an audit can be the predominant contribution of the audit. Where this is the case, the small firm is able to engage the services of the auditor and derive the advantages of such while not conforming to all the requirements for an unqualified opinion.

Conclusion

Many companies have engaged the services of an external auditor on an involuntary basis. Others, in the position of making a choice, often do so with inadequate consideration. The apparent product of an audit — the auditor's report — may be only a small portion of a host of services evolving from the examination. For a small firm, these attendant services can provide access to expertise not possible from within.

The owner of a small business must carefully weigh the benefits which may possibly result from the relationship with the auditor against the costs involved. Clearly this entails consideration of a number of factors, the more obvious of which may be the least significant. Throughout this consideration the proprietor must bear in mind that a positive contribution to a business on the part of a skilled professional can return its cost many times over. The decision, then, must not be made lightly.

Women In Accounting Education

By Stanley Atkinson, Carole Cheatham, J. Larry Hagler, and James H. Sellers

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This seems a time when it is popular to survey women in various fields. Women accountants have not been neglected in this respect. Some very fine studies have been done on women CPA's;[1] however, information specifically relating to women in accounting education has not been as vigorously compiled.

In the fall of 1975, a questionnaire containing fifty-five questions relating to faculty salaries, professional rank, teaching load, and other related items was mailed to 1,059 members of the American Accounting Association.[2] The sample selected was a geographically stratified random sample of the Association's academic members. The response rate was 53%. Among those responding were forty-six women educators. The purpose of this article is to report the results of the segment of this survey regarding women in accounting education. Secondarily, these results are contrasted with two studies of women CPA's and with the results of the overall survey of American Accounting Association members.

General Characteristics

The women respondents to this questionnaire were all United States citizens and were predominantly white (95.7%). Most were married (74%) and many were married to spouses with advanced degrees (65% of those married) or spouses who had attended graduate or professional schools (12%). The women educators lived in towns or cities of various sizes — about half lived in cities of over 100,000 and about half in cities of less than 100,000.

As to age, 28% of the respondents were in their 50's and 28% were in their 30's. For the other age ranges, 13% were below 30, 22% were in their 40's, and 9% were over 59. Politically, the respondents generally characterized themselves as middle-of-the-road (28.3%) or moderately conservative (47.8%.)

School Characteristics

Many of the women in accounting education were teaching in smaller schools; twenty (43.5%) were teaching at schools with an enrollment of less than 5,000. However, five were teaching in institutions of over 15,000 enrollment. Approximately 52% were teaching at state or locally supported colleges or universities while about 41% were teaching at state or locally supported junior colleges. Only 7% were teaching at private schools.

The women accounting educators reported 58.7% of their schools offered bachelor degrees in business, 52.2% offered master's degrees in business and 10.9% offered doctorates in business.

Professional Characteristics

Professionally, fourteen of the women were at the professor level, ten were at the associate professor level, thirteen were at the assistant professor level, eleven were at the instructor level and one had another title. In regard to administrative functions, one respondent was a dean, and five were chairmen. Of the respondents, 58.7% were tenured.

Regarding terminal degrees, 19.6% of the respondents were Ph.D's, 4.4% were DBA's, and 6.5% were Ed.D.'s. Thus, overall, 30.5% of the women educators had obtained the doctorate. Since professional certification is considered important for educators, this area was investigated. It was found that none was a CIA, one respondent (2.2%) was a CMA, and twenty-eight (60.9%) were CPA's.

A great deal of attention has been focused by state legislatures on the low teaching loads of professors. Thus, one question in the survey pertained to this area. For the women, teaching loads varied: two taught less than 6 hours, one taught 6-8 hours, eleven taught 9-11 hours, fifteen taught 12-14 hours, and seventeen taught 15 hours or more. One should keep in mind the fact that six of the respondents were administrators who normally receive a reduced load. Generally speaking, it would appear that women professors of accounting teach a full schedule. A breakdown of the women educators' time spent in various activities is given in Table 1. A heavy preponderance of time was spent in undergraduate teaching, preparation and advising.

In regard to years of service, 10.9% reported they had been working less than one year at a college or university (beyond the teaching or research assistant level), 26.1% had been teaching 1-5 years, 34.8% had been teaching 6-10 years, 21.7% had been teaching 11-20 years, and 6.5% had been teaching over 20 years.

Women accounting educators appeared to be more oriented toward teaching as opposed to research. A total of 76.1% reported their interests to be exclusively in teaching or very heavily in teaching. Another 15.2% reported interests in both research and teaching but leaning toward teaching. Only 6.7% were leaning toward research (4.3%) or very heavily interested in research (2.2%). The teaching rather than research orientation also showed up in

TABLE 1

HOW WOMEN ACCOUNTING EDUCATORS SPEND THEIR TIME
(Percent Responding in Each Category)

Activity	Percent of Time Spent 0-19%	20-39%	40-59%	60-79%	80-100%
Undergraduate teaching	4.3	4.3	17.4	26.1	47.8
Graduate teaching	84.8	8.7	4.3	0	0
Research	84.8	10.9	4.3	0	0
Administration	78.3	10.9	4.3	0	4.3
Professional service	91.3	6.5	0	0	2.2

Job Satisfaction

Job satisfaction was probed in the survey. Respondents were asked to rate several items involved with job satisfaction. The results of these ratings are presented in Table 3. Sources of some dissatisfaction appear to be administration support of research and publications, legislative support of higher education, the institution's share of the state budget and compensation of educators compared to those outside academia.

TABLE 3

JOB SATISFACTION
Percentage of Respondents

Items	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Satisfied with independence	54.3	39.1	4.3	2.2	0
Administration supports research and publications	8.7	13.0	32.6	21.7	23.9
Student evaluation a part of promotion	4.3	34.8	28.3	19.6	13.0
Influence department decisions	15.2	50.0	6.5	19.6	8.7
Pleased with administration	15.2	39.1	13.0	17.4	13.0
Legislature adequately supports higher education	2.2	28.3	15.2	32.6	19.6
Institution receives fair share of state budget	2.2	28.3	23.9	28.3	17.4
Department receives fair share of university budget	2.2	37.0	21.7	26.1	13.0
Fairly compensated relative to people outside academic with similar training	4.3	30.4	15.2	26.1	23.9
Fairly compensated relative to people in own department	13.0	50.0	10.9	17.4	8.7

the number of professional writings in the past two years — 80.4% reported no writings, 15.2% reported 1-5 writings, 2.2% reported 6-10 writings and 2.2% reported 11-20 writings.

Compensation

The basic institutional salaries of the women accounting educators are given in Table 5. The distribution is somewhat bimodal with ten respondents in the \$12,000-\$13,999 range and nine in the \$20,000-21,999 range. The median salary is \$16,000-17,999. Some of the salaries reported in Table 5 are 11/12 month salaries; however, most respondents (82.6%) were on 9/10 month contracts.

Table 2 presents a breakdown of women's compensation by terminal degree. Salaries of those with doctorates are compared to those without doctorates. This comparison, of course, does not indicate years of service or other related items which affect salaries. As might be expected, those with doctorates were generally receiving better pay. However, there were five women without doctorates at the \$20,000-21,999 level for 9/10 months.

In comparing salaries of women in accounting education by rank instructor's salaries generally ranged from \$10,000-14,000 on a 9/10 month basis, assistant professor's salaries ranged from \$10,000-18,000, associate professors made from \$12,000-22,000 on a 9/10 month basis, and full professors' all made over \$18,000.

Some women in accounting education also indicated they had earnings outside their basic salaries. A few of the respondents (4.3%) had as much as 50% over their basic salary. The same percentage (4.3%) had 30-39% over their basic salary while 15.2% reported additional earnings of 20-29%, 23.9% had 10-19% additional earnings and 42.2% had less than 10% additional earnings. Some of the major sources of outside income were private practice; consulting; and dividends, interest and rent. As might be expected, summer teaching was a source of additional income to many as well as other teaching in night school, or in extension facilities.

Comparison with Studies of Women CPA's

An effort was made to compare this study of women accounting educators with two studies of women CPA's. The studies of women CPA's included a study by Elise Jancura in 1973 on behalf of the AWSCPA and a study by Constance Barcelona and Clara and Thomas

Lelievre at the University of Cincinnati in 1974[3]. The survey of the American Accounting Association membership was not designed to be compatible with these two studies but some comparisons can be made.

It appears that women in accounting education are generally somewhat older than women CPA's. There are fewer women educators in the under 30 bracket and more in the over 50 bracket. This result is not surprising considering the educational requirements for teaching which postpone active employment. Educationally, the women accounting educators had a higher percentage of doctorates. The University of Cincinnati study showed 3.8% of the women CPA's had Ph.D's while Dr. Jancura found a like percentage (3.8%) of doctorates. It was found that 30.5% of women accounting educators had some type of doctorate. This comparison is certainly not surprising in view of the emphasis on the doctorate in the education field.

Dr. Jancura reported 50.7% married and 14.4% divorced, separated or widowed. The study of women educators showed 73.9% married and 10.8% divorced, separated or widowed. The higher percentage of married women among educators may be because of their higher age.

In regard to experience, the median range of full time teaching experience for the women was 6-10 years, as was also the median for the overall group. However, the women had fewer in the over 10 year category (28.2% as opposed to the overall 41.8%) and more in the 0-5 years category (37% of the women vs. 27.1% overall).

The women had not done as well at publishing as the general group. Approximately 80% of the women had not published anything in the last two years while only 52.7% of the overall group had not published. Thirty-nine percent of the general group had published one to five articles in the last two years and 8.3% had published over five articles. Only 15.2% of the women had published one to five articles and 4.4% had published over five.

More of the women were teaching at junior colleges (37.0% as opposed to 13.1% overall) and fewer were teaching at universities (47.8% women as opposed to 65.7% overall). As to rank, the women generally did not possess as high a rank as the overall group. Only 23.9% of the women were full professors whereas 31.7% of the overall group were

TABLE 2

SALARIES OF WOMEN WITH AND WITHOUT DOCTORATES

	With Doctorate Type of Contract		Without Doctorate Type of Contract	
Amount of Salaries	9/10	11/12	9/10	11/12
Under 10,000	0	0	0	0
10,000-11,999	0	0	8	0
12,000-13,999	1	0	8	1
14,000-15,999	1	1	2	0
16,000-17,999	0	1	2	1
18,000-19,999	1	1	3	1
20,000-21,999	1	3	5	0
22,000-23,999	1	1	0	0
24,000-25,999	0	0	0	0
26,000-27,999	1	0	0	1
28,000-29,999	0	1	0	0
Over 30,000	0	0	0	0
Total	6	8	28	4

Women in accounting education were also asked to respond to the question, "How likely is it that you will be seriously considering the following positions anytime within the next five years?" Responses to this question are presented in Table 4. The most highly likely moves for most of the women appear to be to higher positions at the same school.

Perhaps more to the point, teachers were asked, "Are you now negotiating for, or have you already found or accepted another position for the fall of 1976?" Forty-four of the women replied no and two did not answer this question. A second question asked, "If NO, are you looking for another position?" Five women answered yes to this question. Finally, the question was asked, "If NO, would you seriously consider a reasonable offer of another position?" Eighteen replied yes to this question.

TABLE 4

LIKELY FUTURE MOVES FOR WOMEN IN ACCOUNTING EDUCATION
(Percentage of Respondents)

	Highly Likely	Somewhat Likely	Somewhat Unlikely	Highly Unlikely
Position in industry	2.2	26.1	8.7	63.0
Higher rank at same institution	19.6	8.7	19.6	52.2
Research position at AACBS	2.2	2.2	8.7	87.0
Faculty position at AACSB school	4.3	21.7	17.4	56.5
Position in government or non-profit organization	2.2	15.2	13.0	69.6
Faculty position at non-AACSB school	4.3	19.6	10.9	65.2
Administrative position in research unit	0	6.5	10.9	82.6
Administration position in university or college	2.2	15.2	10.9	69.6
Will be retired by 1980	8.7	8.7	6.5	76.1

TABLE 5

BASIC ANNUAL COMPENSATION OF ACCOUNTING EDUCATORS AND WOMEN ACCOUNTING EDUCATORS

Percentage of Respondents

Amount of Salaries	Accounting Educators	Women Accounting Educators
Less than 10,000	1.6	0
10,000-11,999	5.0	17.4
12,000-13,999	8.0	21.7
14,000-15,999	10.1	8.7
16,000-17,999	18.1	8.7
18,000-19,999	15.9	13.0
20,000-21,999	13.5	19.6
22,000-23,999	4.8	4.3
24,000-25,999	9.7	0
26,000-27,999	5.3	4.3
28,000-29,999	3.2	2.2
30,000-31,999	2.7	0
Over 32,000	2.1	0

full professors. At the associate rank, there were 21.7% of the women and 30.3% of the overall group. At the lower range, 23.9% of the women were at the instructor level whereas only 9.2% of the overall group were at that level.

From a persónal standpoint, the women were slightly older than the general group. The median age range for the women was 45-49 whereas the median age range for the general group was 40-44. There were, however, more women under 30 teaching (13.0% vs. the overall 7.1%). Slightly fewer of the women were married (73.9% vs. the overall 76.4%). One interesting difference was that far more of the women were married to spouses with advanced degrees. Among the women 65% of those married were married to spouses with advanced degrees but in the general group only 23% were married to spouses with advanced degrees.

Profile of the Woman in Accounting Education

The profile of the woman in accounting education is that she is white, married, ranging in age between 30 and 60. She may live in a town of almost any size and is likely to be politically middle-of-the-road or moderate.

The woman in accounting education probably teaches at a relatively small, state-supported school. She has about equal changes of being at the professor, associate, assistant or instructor level. She is probably a CPA but does not hold a doctorate. It is unlikely that she is a dean or department chairman. She spends most of her time in undergraduate teaching, preparation and advising and has less interest in research than in teaching.

Regarding salary, the woman in accounting education may be paid from $10,000 to $30,000, but with more chance of either being in the $12,000-13,999, range or the $20,000-21,999 range. She may earn income outside her basic salary from summer teaching; night school or extension teaching; private practice; consulting; or dividends, interest and rent. Her school generally provides financial help for supplies and equipment, dues for professional organizations, travel to professional meetings, and long distance calls.

Sources of discontent for some women in accounting education are poor administration support of higher education, their institution's share of the state budget, and compensation of educators compared to those outside the academic field. Yet the women seemed reasonably well satisfied overall in regard to salaries when compared to their colleagues. When they were asked if they contemplated leaving their present jobs for another in the fall of 1976, none responded affirmatively although 50% said they would consider a reasonable offer.

Compared to women CPA's, the woman in accounting education is somewhat older, more likely to be a CPA but less likely to have a doctorate. She is less likely to be publishing and more apt to be teaching at a small school. Her rank is slightly lower than accounting educators in general, and she is paid somewhat less.

[1] See Elise G. Jancura, "The Woman CPA: A Professional Profile," *The Woman CPA*, Vol. 26, No. 3 (July 1974), pp. 2-5 and also Constance T. Barcelona, Clara C. Lelievre and Thomas W. Lelievre, "The Profession's Underutilized Resource, The Woman CPA," *Journal of Accountancy*, Vol. 140, No. 5 (Nov. 1975), pp. 58-64.

[2] The questionnaire was prompted by a survey of all teaching faculty at all state supported schools in Ohio by Louis Imundo and Michael Cleary of Wright State University. Because of numerous differences in goals, the questionnaire will only vaguely resemble the aforementioned survey.

[3] Elise G. Jancura, "The Woman CPA: A Professional Profile," *The Woman CPA*, Vol. 26, No. 3 (July 1974), pp.2-5 and Constance T. Barcelona, Clara C. Lelievre, and Thomas W. Lelievre, "The Profession's Underutilized Resource, The Woman CPA," *Journal of Accountancy*, Vol. 140, No. 5 (Nov. 1975), pp. 58-64.

Education

Grade Inflation in Accounting?

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Guest writers this month are Hilda F. Allred, Charles H. Brandon, and Joseph P. Matoney, Jr. of the University of Rhode Island. Professor Allred is Assistant Professor of Business Education and Office Administration, holding an Ed. D degree from Louisiana State University. Professor Brandon, CPA, is Associate Professor of Accounting, holding a Ph. D. from the University of Georgia. Professor Matoney, CPA, is Associate Professor of Accounting, holding the Ph. D. from Pennsylvania State University.

Anyone concerned with recruiting college graduates has probably noticed a rise in the overall grade point averages of potential employees. In addition, the topic of overall grade inflation has been widely recognized in the general press. In an article entitled "Too Many A's," *Time*[1] reported that the undergraduate grade point average was 3.45 at Stanford University. *Time* also noted that on the average, 42 percent of the grades given at Yale were A's and 46 percent of the senior class graduated with honors. An editorial in *The Wall Street Journal* warned of a severe decline in the state of learning because of a nationwide erosion of grading standards.[2] *The Chronicle of Higher Education* reported the results of a comprehensive study of grades given at 197 colleges and universities. Results of the study revealed that grades increased an alarming 40 percent since 1960.[3]

This paper reports the results of a survey of the changes in undergraduate accounting grades at forty-five universities during a ten year period. Our study used a mail questionnaire to determine if grade inflation had occurred at these universities and if so to what degree. In addition to grade data, we obtained demographic information which we used to compare grade levels and changes in grade levels for each institution. Finally, we obtained information from individual accounting department heads regarding their perception of the causes of grade inflation and the impact on potential employers.

The Study

The period of time encompassed by the study was ten years, with grades requested for the Spring term 1965, 1970, and 1975. This time horizon was chosen to include the period of student activism associated with the Vietnam War and the period most identified with rapidly changing grades. We requested the number of A's, B's, C's, D's, and F's rather than grade point averages (GPA's) to eliminate differences in grading scales. Since there is often a different grading policy for graduate courses, we requested grades in undergraduate courses only. Using the data submitted we computed individual overall GPA's based on a uniform four point scale for each institution.

American colleges and universities with undergraduate programs accredited by the American Association of Collegiate Schools of Business (AACSB) served as the basis for our survey. A total of eighty out of a possible 156 AACSB accredited schools (51.3 percent) responded to the initial and follow-up mailings of the questionnaire. All eighty responding institutions completed the first two sections while forty-five completed all three parts of the questionnaire including grade data for the three time periods.

Results of the Study

On the basis of the responses of the forty-five institutions with complete grade data, the overall grade point average rose from 2.299 in 1965 to 2.373 in 1970, an increase of 3.2 percent and from 2.373 to 2.487 in 1975, an increase of 4.8 percent. The overall percentage increase from 1965 to 1975 amounted to 8.2 percent — considerably less than we expected. In addition the total number of accounting grades given at the forty-five responding institutions increased 15.1 percent during the 1965-1970 period, an additional 34.3 percent for the 1970-1975 period, and an overall increase of 54.6 percent for the ten year period. It can truly be said that students are flocking to accounting courses in ever increasing numbers.

While an overall inflation in GPA's was observed, the increase was considerably less than the 40 percent grade inflation for overall college grades reported in *The Chronicle of Higher Education* for the slightly longer 1960 - 1974 time period. Our study indicates a slight upward shift in accounting grade levels resulting in grade inflation significantly lower than that observed for overall college grades.

Looking at the grade changes grouped by institutions, one can see in Table 2 that grade inflation was not a universal phenomenon at the institutions tested. Although the majority of schools showed grade inflation, a significant number (27 percent in 1965 - 1970 and 38 percent from 1970-1975) actually experienced grade deflation. The large majority of schools showing grade deflation were in the 0 - 5 percent and 5 - 10 percent range and none showed grade inflation in excess of 25 percent. Several schools showed grade inflation of over 25 percent in both the 1965 - 1970 and 1970 - 1975 periods.

In the next phase of our analysis we grouped schools according to four characteristics and tested whether differences in these characteristics were associated with differences in either the level of GPA's awarded or the distribution of grades during the periods surveyed. The four characteristics tested were (1) total institution enrollment, (2) the number of accounting majors, (3) the number of accounting faculty, and (4) the type of institution. We found no significant association between any of these four characteristics and the level of undergraduate accounting grades.

Not surprisingly we found that the majority of educators responding to our survey believed accounting grade levels had increased in the last ten years. While some educators did not believe accounting grade levels had increased, their responses may reflect a number of possible explanations: (1) the belief that the grade increases were negligible, (2) that the increases were significantly less than overall grade changes, or (3) that the grades at their institution had, in fact, not increased.

All of those who stated a belief that their school's grades were increasing, also stated that employers had adjusted their screening procedures for hiring accounting graduates. Mixed reactions were reported as to whether or not increasing grades would affect either the quality or quantity of students majoring in accounting. While the majority of respondents thought that increasing grades would have an impact on the profession of accounting, none volunteered what they thought the nature of that impact might be.

A number of explanations have been advanced for changing accounting grade levels. One argument is that students are "better" today than in previous years. This is hard to substantiate because of difficulties in measuring improvement. Although overall college entrance achievement test (SAT) scores have been declining in recent years, it may be that the relatively good job outlook for accounting students and more selective standards for admissions into accounting programs have succeeded in attracting better students.

Another explanation for increasing accounting grade levels is that many institutions have extended the drop period where students performing poorly drop the course rather than suffer a low grade. Still another is the increased popularity of the pass/fail option among nonaccounting majors. It is quite possible that the grades of many of the students who might have performed poorly may not be incorporated into the letter grade averages reported.

One explanation for the reason that accounting grades are increasing at a slower pace than overall college grades might be that accounting courses are basically quantitative and that standards in such courses are easier to maintain than in nonquantitative courses. Standardization of accounting grades may be facilitated through the utilization of uniform CPA examination problems. One additional factor is that quantitative courses may not be as susceptible to the "bribery hypothesis." This hypothesis implies that students through evaluations of their instructors as teachers are able to elicit more favorable grades, hence instructors "bribe" students to give better evaluations by providing higher grades.

Conclusions

Our survey indicated that for the total number of undergraduate accounting grades reported by forty-five institutions, overall grade inflation of 8.2 percent had occurred during the ten year period, 1965-1975. Despite differences in the schools and the time period surveyed, this appears substantially less than the 40 percent overall grade inflation reported in *The Chronicle of Higher Education.*

Analysis of the grade changes of individual schools indicated that a substantial number of institutions during the 1965 - 1970 and 1970 - 1975 periods of comparisons actually showed grade deflation in accounting. Where such deflation was found, however, the amount of change in overall GPA was smaller than the change reported by schools experiencing grade inflation.

Our test of various characteristics that we thought might be associated with differing grade levels disclosed no statistically significant relationships. Thus we found no significant association between the level of grades reported and either the number of students enrolled in the institution, the number of accounting majors, the number of accounting faculty or the public versus private nature of the institution.

The department heads who reported grade inflation for their departments unanimously agreed that prospective employers of accounting majors were aware that grade inflation had occurred and a substantial majority believed recruitment screening procedures had been adjusted because of it.

REFERENCES

[1] "Too Many A's," *Time* Magazine, November 11, 1974, p. 40.

[2] *Wall Street Journal*, December 30, 1974, p. 8.

[3] "Marks Have Risen Significantly Since 1960 at 197 Colleges," *Chronicle of Higher Education*, October 7, 1974, p. 2. This "news" story was a resume of research conducted by A. Jvola, Michigan State University, East Lansing.

Table 1

Overall Distribution of Undergraduate Accounting Courses
Grades and Overall Weighted Average GPA's

	1975		1970		1965	
Grade	Number	Percent	Number	Percent	Number	Percent
A	10,443	20.7%	6,413	17.1%	5,077	15.5%
B	15,750	31.2	10,959	29.2	9,377	28.8
C	15,619	30.9	13,292	35.3	11,266	34.5
D	5,297	10.5	4,103	10.9	4,101	12.6
F	3,377	6.7	2,827	7.5	2,829	8.6
	50,486	100.0%	37,594	100.0%	32,650	100.0%
Overall GPA	2.487		2.373		2.299	

Table 2

Distribution of Schools by Percentage Changes
in Institutional GPA's

1970 - 1975

	Number	Percent	0-5%	6-10%	11-15%	16-20%	21-25%	26% & over
Increases	28	62%	11	6	5	2	1	3
Decreases	17	38	7	7	0	2	1	0
	45	100						

1965 - 1970

	Number	Percent	0-5%	6-10%	11-15%	16-20%	21-25%	26% & over
Increases	33	73%	9	8	4	5	3	4
Decreases	12	27	7	5	0	0	0	0
	45	100						

Electronic Data Processing

A Survey of Electronic Funds Transfer Systems

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Electronic Funds Transfer (EFT) is a new payment medium which substitutes electronic messages for pieces of paper, such as checks, invoices and deposit slips. EFT can greatly reduce the burden of paper handling and operating costs in recording financial transactions. It is estimated that the nation's banking system alone handles a daily load of about 30 billion checks. In addition to banks, EFT will also help relieve the paper handling burden in retail stores, payroll departments and service companies that mail out bills at regular intervals, such as insurance companies and utilities. The Federal Government already deposits more than 3 million monthy social security checks per EFT.

At the same time, EFT also represents potential problems. These are potential loss of control by the consumer over his own financial affairs, concern over the loss of privacy, the possibility of unauthorized access to an individual's financial records by outsiders, the loss of float, and a number of as yet unresolved legal issues such as questions of consumer rights, interstate commerce, and the question of legalized branch banking. Other conerns are centered on the potential loss of proof of payment in the EFT system and of the ability to stop payment.

Automated Teller Machines

Electronic Funds Transfer facilities can appear in several different forms. One form is the Automated Teller Machines (ATMs) which are unmanned devices capable of dispensing cash and performing certain other simple services. These devices may be located on the physical premises of a bank itself or be at some remote location. They may be stand-alone or they can be on-line to a central computer. When an ATM is installed as an on-line device to a bank's central computer, it can provide more extensive services because that arrangement allows access to the bank customer's records and therefore provides the opportunity for greater transaction variety.

The use of ATMs is in the period of some uncertainty. There have been contradictory court decisions as to whether these ATM devices should be considered a branch bank and therefore be subject to branch approval regulations. ATMs have the potential to materially reduce the investment for branch facilities and to provide considerable savings in the central banking location with a potential for reduction in teller and other operating costs. Proper placement of ATMs also represents an important competitive tool for banks which are interested in expanding and increasing their share of the financial business of a given area. One possible solution to the current uncertainty over the definition of a branch bank would be to exclude specific types of transactions performed by these ATMs from the definition of branch banking.

One other question which exists in the use of ATMs centers upon the issue of possible sharing of ATMs among all financial institutions of a given area. Many in the banking industry associate the competitveness of branch placement with the ATM. On the other hand, nonbanking interests point out the need for a universal ATM available to their employees and customers whatever bank they may use. The installation of ATMs has been slowed by these as yet unresolved questions and also by the cost of purchasing and installing ATMs. To date these have been relatively expensive facilities to install although the expectation is that the price of these devices may decrease dramatically in the next several years.

If, in fact, future developments produce an inexpensive ATM unit and the legislative questions are resolved, one could expect that there will be a great increase in the installation of ATM units. These units could be placed in heavy traffic locations providing a convenient cash-dispensing or check-cashing service on a 24 hour basis. Once users become accustomed to the practice of using an unmanned automated device for cashing checks, the stage might be set for the extension of these automated services to other activities such as transfer transactions or bill paying.

Point of Sale Terminals

Point of Sale Terminals (POS) are manned devices usually located at the checkout counters of retailers. These devices have been in operation for a number of years and have made the process of maintaining store records on sales, inventories and accounts receivable more efficient, and therefore, less costly. A logical extension of the use of traditional POS devices has been to use these devices to record transactions involving the banking activities of the retailer and the retailer's customers. Thus the retailer can provide a facility in which the retailer's customers can cash checks, make deposits or initiate other transfers from their accounts directly to the retailer.

The POS devices allow the banks to extend services to their depositors at convenient locations with relatively small investment on the part of the bank. Use of POS facilities diminishes the personal contact between the financial institution and its customers and further, makes it relatively difficult for the customer to distinguish one bank from another. Since the POS devices are manned by the retailer's clerks, the bank cannot exercise control over the level of customer service and, therefore, satisfaction. On the other hand, POS networks do represent a service to the customer by allowing a combination of banking and shopping activities. POS also represents an advantage for the retailer, for it represents another service which the retailer can advertise which will help draw more customers into the retailer's store. Further, it can help reduce check losses to the retailer through immediate direct verification procedures when a check is presented for payment.

EFT provides the technological capability to abuse civil liberties by concentrating information which was formerly scattered and making that information accessible and processible. Thus on the one hand legislative activity is expected to function in an enabling fashion by encouraging the development of EFT techniques. On the other hand there is expectation of legislative activity which will regulate EFT development to protect consumers' privacy and other rights.

Many consumer advocate groups and legislators are concerned that EFT could expose confidential records to unauthorized scrutiny, violating the consumer's right to privacy. To protect the consumer's rights, privacy laws will have to be modified extensively to include EFT facilities. The system developers must be required to incorporate strict security and control provisions while establishing EFT systems. It is expected that the majority of this legislation will be on a federal level in order to insure consistency and to support interstate operations of the required networks, particularly the use of interstate telephone lines.

Most EFT networks under development are being structured to be shared. This is an economic necessity because of the high cost of development and programming for these projects and the fact that they become economically feasible only if there is a sufficiently large group of users who can participate in the services of a given facility. The regulatory agencies have recognized this need and have encouraged shared networks as a pre-condition to approving a facility. This requirement is expected to become more generalized and be incorporated in legislation governing EFT. Thus it is expected that legislation regarding EFT will probably include anti-trust considerations with rules applied very stringently where ATM and POS devices are installed on a sight other than the location of the sponsoring financial institutions.

EFT has the potential to provide substantial operating savings to financial institutions, to private businesses, to retailing operations, and to the consumer directly. At the same time, however, EFT also has the potential to introduce certain problems such as loss of certain freedoms and the potential for violation of individual privacy and the loss of a degree of control over one's financial transactions. The sometimes conflicting interests of the several different groups potentially involved in EFT — the financial institutions, the retail stores, the consumers, and the government — suggest a very important roll for government regulation in the future development of EFT systems. Thus future government action can probably be characterized by two principle objectives: to insure that the consumer shares in the benefits of EFT; and to stimulate greater competition amongst all institutions that provide financial services.

Large scale introduction of POS terminals as a part of an Electronic Funds Transfer facility requires that there be a fairly significant development of standardized communication systems. The retailers involved do not want to be in the position of determining where customers bank. Therefore, POS terminals installed at a retailer's location to handle EFT functions must be able to communicate with a number of different banks in order to be effective. Further, retailers are concerned with the potential impact of adding banking services to their normal POS activities on the average wait-time for customers as they stand in lines.

An indication of the potential of POS terminals for Electronic Funds Transfer is offered by Continental Bank of Chicago. As reported in a recent conference, Continental Bank has terminals installed in 300 Kominick stores, 180 National Tea stores, eight Treasure Island stores, twelve Wieboldts, and one regional amusement park. The bank's network handles 1 million transactions per month. Terminals currently handle Master Charge authorization and check approval in from two to five seconds. In the same processing network, Continental Bank also has fourteen automated teller machines.

Many of the POS terminals that are currently linked with financial institutions are presently limited to performing check-guarantee or check-verification functions for the retailer. However, several systems are now in operation which have expanded the service to posting actual monetary transactions. The major credit card associations are working on plans for the development of debit card capabilities.

Once again, however, the legal situation is somewhat unclear since several courts have ruled that the acceptance of deposits and handling of monetary transactions make these POS devices act as branch banks. To avoid being classified as branch banks, many current POS networks treat monetary transactaions simply as transfers between the retailers and the customers accounts.

Automated Clearing Houses

Still another form of EFT is the Automated Clearing House (ACH). The ACH is an organization which supports the exchange of electronic value transactions between customers of member banks (and in some cases other financial institutions). It is formed by the commercial banks and is patterned after the traditional clearing house associations organized in most cities to centralize the physical exchange of checks among member banks. Currently much of the activity in ACHs takes the form of direct deposit of government and payroll checks and of pre-authorized payments.

Payments and the off-setting credit are shown by electronic rather than paper entries, and the exchange or clearing is performed by transferring electronic images rather than the physical documents. Typical credit transactions in an ACH are regular pre-authorized deposit transactions recorded on magnetic recording media such as payrolls, interest, and dividend payments. Debit transactions are usually the payment of recurring bills such as insurance, utilities, and mortgage payments. Member banks support this facility because of its function in reducing the substantial check-handling costs incurred in an increasing volume of checks.

According to a survey conducted in August, 1976, there are now seventeen operating Automated Clearing Houses which process a total of more than 400,000 transactions per month. At that time membership in the seventeen ACHs consisted of more than 5,200 commercial banks and thrift institutions. Sixty per cent of the credits had originated from the government and credit transactions represented 75 per cent of the total volume. The types of transactions currently handled by ACHs are limited because they have been set up to perform transfers among the members of a particular ACH. Gradually, these individual ACH organizations have begun to develop the ability to transfer data amongst themselves. The recent adoption of standards governing inter-ACH processing will greatly facilitate a national information exchange network and should greatly expand the impact of ACH activities. everywhere.

Presently the Federal Government itself is one of the heaviest users of ACHs. As of January, 1976 over 2.7 million social security checks were being deposited directly into recipient's accounts and will all flow through the national ACH network when it is completely established. In addition, the U.S. Civil Service Commission has announced plans to offer direct deposit services. Many of the currently existing ACH networks also process transactions using Federal Reserve computers.

The obvious advantage to a financial institution of an ACH is the reduced operation costs in check handling and teller operations. However, it is generally recognized by most financial institutions that paper entries will not totally disappear and therefore the need will continue to maintain a dual processing system.

Consumers too can benefit from the availability of an ACH facility. Benefits to the consumer are the convenience of having payroll deposits made automatically at a bank of choice and the reduction in clearing delays such as the time required to receive a check in the mail and physically travel to the bank. In addition, the ACH can provide added security since it greatly reduces the opportunity for loss or theft of checks or other materials. Further, preauthorized payments can eliminate the effort and expenses of writing checks and mailing payments.

Despite these benefits, many customers feel uneasy with direct deposit and automatic payment. Some object to the loss of control which they have when they control the initiation of payments or deposit of funds directly. Another matter which concerns some users is the loss of float and the loss of the use of grace period on preauthorized payments.

Automated Telephone Payment

Automated Telephone Payment (ATP) requires the availability of a Touch-Tone telephone. ATP allows the user to initiate payments or transfer funds between accounts through the Touch-Tone telephone. The user enters an identification number, a transaction code, and the dollar amount via the keys on the telephone. The user established his connection with the network by dialing the network's telephone number and the network then routes the user's instructions to the financial institution where the user's account in maintained.

The advantages of an ATP to the financial institution is the reduction of paper handling problems and operating costs. The benefit to the user is ease and convenience. The user does not have to prepare checks, is not limited by banking hours, can save postage and/or travel time, and can draw on funds in interest bearing accounts. In addition, with this approach the user can control the actual amount and timing of the funds disbursement as compared to the automatic payments procedure discussed above. ATP systems, however, do have some potential problems or disadvantages. To the financial institutions there is a high development and promotional cost which makes this system attractive only when the potential exists for a large volume operation. In addition, the ATP system provides scant or little documentation to the user. Many potential customers find it difficult to overcome the fear that such lack of documented proof of transactions, particularly payments made, make resolution of errors extremely difficult.

Legislation and Government Regulation Affecting EFT

Several provisions of the McFadden Act prohibit financial institutions from establishing branches across state lines contrary to state law. Currently fifteen states prohibit branch banking. Several court rulings have held that certain EFT facilities, primarily the ATMs or Automated Teller Machines, constitute branch banks. The existence of such legal limits have acted to severely retard the installation and development of EFT facilities.

At the INFO '76 Conference in Chicago, Joel Crabtree of Continental Bank of Chicago predicted the passage of electronic banking legislation at both the state and local level in the coming year. Such legislation is expected to take the form of clarifying the question of branch bank status for EFT units and the expected repeal of those provisions of the McFadden Act that concern themselves with branch banking across state lines.

At the Data Processing Management Association's INFO/EXPO '76 in Las Vegas, George Glaser suggested that there are four areas of law which bear on EFT. The first he identified as legislation affecting branch banking. In addition, however, he felt that privacy legislation, universal commercial code, and anti-trust legislation represent three other areas of the law which bear on the development of Electronic Funds Transfer and in which one could expect to see future activity.

Editor's Note:

Once an individual has properly budgeted and planned her income and expenditures, she should start saving funds for emergencies, major purchases, and retirement. The first need that should be met is a secondary cash reserve in short-term liquid assets. How much each person will need in secondary reserves depends upon her responsibilities (supporting children and other dependents), her insurance coverage (the topic of a future column), and her standard of living. The old rule used to be that a person should have the equivalent of six months' take-home pay in secondary cash reserves. If one is adequately insured and/or is a member of a two-income family, the secondary cash reserve can be less. Regardless of the size of the reserve, one should be aware of the alternative short term investments available. To just stash the money in a savings account can be counterproductive, as is shown in the following article by Dr. Helm.

Personal Management

Savings Accounts and Short-Term Investments

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As inflation continues to erode the dollar's purchasing power, there has developed an increased need for use of good judgment in the handling of funds acquired in excess of those needed to meet living expenses and other commitments. To gain protection against inflation one needs yields greater than the inflation rate. Yields (after taxes) of sufficient magnitude to offset the present six percent inflation rate can be obtained only through investing in securities which provide chances for capital gains (common stocks and bonds).

Since 1966, however, long term holdings of common stocks have produced losses for many owners, creating a greater problem than the one produced by inflation alone. Also, bond owners have experienced problems as widely swinging interest rates have produced real as well as opportunity losses.

The thesis of this article is that funds should not be invested and left alone. They should be managed astutely, meaning that during some time periods, they should be concentrated in short-term investments and at other times, in long-term situations.

Secondary Reserve

The first step in developing an investment program is to establish the amount of demand deposits that will be needed to cover all expenses and near-term commitments. The level to keep demand deposits should be selected. It will vary in accordance with individual circumstances. It should be adequate, but not excessively large. Other than a feeling of security, there is little to be gained from keeping large amounts of money in demand deposits.

In addition to the minimum cash balance it is desirable to establish a secondary reserve consisting of savings accounts, certificates of deposits, and short-term money market instruments. The amount of funds which should be allocated to the secondary reserve depends on the possibility of a sudden need for funds which could result in losses should long-term investments have to be sold during unfavorable markets. Rather than liquidate long-term investments, possibly at losses, funds could be drawn from the secondary reserve, and losses prevented.

The size of the secondary reserve to maintain would depend on long-term security market forecasts. There have been instances when common stocks have advanced for years. During these periods, large secondary reserves would not have been needed for even had forced sales developed, the probability would have been good that long-term securities could have been sold at profits rather than losses. The same applies for bonds, although the opportunities to sell at profits have been much shorter time periods than those for common stocks. When common stocks are advancing on a strong front, and when bond prices are increasing, secondary reserves should be kept at low levels. When the prices of stocks and bonds are falling, secondary reserves should be increased.

Investment Risks

To assist in making decisions about whether to be concentrated in long-term or short-term commitments, it is helpful to understand the risks associated with various types of investments. These risks are: purchasing power risk, interest rate risk, financial risk, market risk, and psychological risk.[1] Purchasing power risk is the risk of inflation eroding purchasing power. The interest rate risk is the risk of loss due to sale of fixed securities after interest rate increases. Financial risk is the risk of loss associated with ownership of securities issued by firms in financial difficulty. Market risk is the risk that a security will lose its marketability. Psychological risk involves such problems as going along with the crowd, buying high, selling low, and failing to act because of psychological blocks.

In respect to the investment risks that have been mentioned, it should be pointed out that the interest rate risk applies only when interest rates are advancing, and the purchasing power risk only when prices of goods and services are advancing. In the past there have been times when interest rates have declined, and there have been periods of deflation. However, the weight seems to be on the side of continued inflation and high interest rates.

Perhaps a more detailed explanation of the interest rate risk should be included. What interest rates advance, ignoring maturities, the prices of all fixed securities (bonds and preferred stocks) decline. As interest rates advance, outstanding fixed securities have to compete with newly issued securities offering higher and higher yields. To attract buyers, holders of fixed securities have to drop prices to levels which will provide buyers with yields comparable to those of other securities offered in the market place. When interest rates declind, the exactly opposite relationship exists. New securities carry lower and lower yields.

When interest rates are expected to decline, the exactly opposite should be increased. Conversely, if interest rate advances are expected, short-term securities should be held.

When conditions seem to warrant extensive upward moves in common stock prices, secondary reserves should be lowered and common stocks purchased. On the other hand, when stock prices are high and appear ready to decline, common stocks should be sold and secondary reserves increased.

Detailed explanation of conditions which warrant switching from long-term to short-term securities and vice versa will be covered in a future article. In this article it is desired to limit discussion to short-term investments although some concepts pertaining to investment policy are considered appropriate for inclusion at this point.

Be Prudent

Don't lose your money. Money has earning power which can extend years into the future. In fact, it is the compounding of interest and dividends that builds the large sums insurance companies hold as reserves against their outstanding policies. Many states have "Prudent Man (sic) Laws" which require that the actions of individuals and corporations handling funds of others be the actions of prudent persons. Some states are even more restrictive and limit trust department investments to securities included in a Legal List compiled by the Secretary of State.

Individuals, of course are not restricted by Legal Lists, but they should be prudent, which means they should be careful in selecting investments with the main objective being safety of principal. The "Prudent Man (sic) Rule" focuses solely on risk of loss, and on minimizing such risk on each security in a portfolio rather than on a portfolio as a whole. Judicial decisions have stressed loss of principal rather than loss of purchasing power and have held preservation of capital more important than yield received.[2] The first rule for the individual, also, should be DO NOT LOSE YOUR MONEY!

Checking and Savings Accounts

Viewed in terms of prudency, it is unwise for an individual to deposit funds in, or to purchase credit instruments of financial institutions which do not provide deposit insurance. There are still commercial banks which do not provide Federal Deposit Insurance Corporation protection and savings institutions which do not have savings accounts insured with the Federal Savings and Loan Insurance Corporation. Funds deposited in institutions which do not insure accounts subjects an investor to financial risk because banks and savings institutions can have financial difficulties the same as business corporations. Don't lose your money in an uninsured bank or saving institution. Spread your funds around, keeping no more than $40,000 (the maximum that can be insured) in any one saving institution.

Although some institutions permit early withdrawal, it is usually assumed that funds placed in savings accounts will be left for at least thirty days. Even should funds have to be left for thirty days, the interest rate risk is minimal as normally interest rates do not swing widely in periods as short as one month. There is no financial risk if accounts are insured, but there can be considerable erosion of purchasing power if funds are left for long periods of time in savings accounts.

Certificates of Deposits

Whereas pass book savings accounts have no maturity date, the same is not true for certificates of deposits (CD's). Since the early 1960s commercial banks and other savings institutions have been permitted to issue negotiable certificates of deposits carrying varying maturities. Some CD's are issued for periods as short as one month; others may not mature for several years. The length of time to maturity and the rate of interest these credit instruments pay are determined by negotiation between issuers and purchasers. However, in the case of CD's in denominations of less than $100,000, yields can not exceed maximum levels established by the Federal Reserve System and the Federal Home Loan Banks.

The longer the time to maturity, the greater the interest rate risk and the higher the yield available on CD's. However, certificates of deposits are marketable which means they can be sold at discount to gain liquidity. The market for CD's is not too well developed, and a problem could develop finding a buyer for a specific CD. If interest rates are expected to advance, funds allocated for investment in CD's should be kept in ones having short maturities so that funds can be reinvested frequently at higher yields.

Do not purchase CD's having maturities beyond the time when liquidity will be needed. Redemption of CD's prior to maturity results in penalties which usually amount to reversion of interest paid on the funds to the pass book rate and an additional penalty amounting to three months interest. However, if early redemption of CD's is for the purpose of settling an estate, many states have passed laws which prohibit collection of penalties.

Foreign CD's

With an inflation rate of six percent, it is obvious that five percent before taxes (approximate yield available during recent years in the United States on pass book savings and short-term CD's) will result in erosion of purchasing power. As a result, many investors have shifted funds into foreign securities, especially foreign CD's. By doing so they have subjected themselves to an additional risk, the risk of loss due to a change in foreign exchange rates.

Significant losses have occurred. The most recent was a result of the devaluation of the Mexican peso. Holders of CD's issued by Mexican banks probably have irrecoverable losses. To bring their money home they will have to exchange pesos for dollars at rates far below the rates existing just a few short months age. Their plight brings to mind an ancient axiom, "the return of money is more important than the return on it." When purchased, the Mexican CD's were paying higher yields than those available in the United States. They looked attractive. The problem is that holders may never get their money back.

Quality Defined

Discussion to this point has assumed that savers will leave their savings with, or purchase CD's of, only financial institutions which provide deposit insurance. There are, however, other credit instruments having short maturities which are available from governmental bodies or business corporations which are appropriate for inclusion in a secondary reserve but are not insured. When considering the purchase of credit instruments of non-insured types, decisions must be made pertaining to the quality of the issue.

In financial terms "quality" is defined usually as the ability of the issuer to meet interest and principal payments. Since the Federal Government (through the Federal Reserve System) can print money, its securities are considered to be of higher quality than securities of other governmental bodies or business corporations. Therefore, if one defines risk as the chance of loss, there is less risk associated with the ownership of Federal Government credit instruments than the risk that exists through ownership of all other types of credit instruments. If risk is defined not as the chance of loss, but as the probable variance of actual return and expected return,[3] Federal Government securities (if held to maturity) have less risk than any other credit instrument.

It should not be overlooked, however, that Federal Government issues expose holders to high levels of purchasing power risk and, if sold prior to maturity, the interest rate risk comes into play.

United States Savings Bonds

The United States Government issues treasury bills, treasury notes, and treasury bonds which are traded in either the money market (where short term securities are traded) or in the capital market (the market for long term securities). Two types of United States Government issues are non-transferable, and therefore are not traded in either the money or capital markets. These issues, Series E and Series H, which cannot be used to collateralize loans, differ in that Series E bonds are sold at a discount from their face value whereas Series H bonds are sold at par and interest is paid to owners semi-annually.

Series E bonds are available to the public in denominations ranging from $25 to $10,000.[4] They are sold at seventy-five percent of par. Series H bonds are issued at face (par) amount and are available in denominations of $500, $5,000 and $10,000 with individual investors limited to the purchase of no more than $10,000 in any one year.[5]

Owners of Series E and Series H bonds may obtain payment upon presentation and surrender of the bonds to a Federal Reserve Bank or Branch or to the Department of the Treasury. Usually the redemption of Series E bonds initiates at commercial banks that are agents of the Treasury. Tables that are up-dated monthly are used to determine the value of Series E bonds based on their date of issue.

For Federal income tax purposes, interest received by Series H bond holders is handled the same as any other type of interest received. It must be reported in the year received. In the case of Series E bonds, however, owners who are cash basis taxpayers may either defer reporting the increase in the value of their bonds to the final maturity, actual redemption, or other disposition, whichever is earlier; or elect to report the increases each year as they accrue.

Failure to accrue and report Series E interest can present problems when estates having Series E bonds among their assets are distributed to heirs. The bonds can be transferred to heirs and the tax liability deferred. However, if the bonds are redeemed, a tax liability amounting to the difference between the cost of the bonds and the amount received is created; and this liability applies to the year the bonds are redeemed even though the increased value may have taken place over many years in the past.

As far as risk is concerned, both Series E and Series H bonds rate low in terms of financial risk, but high in purchasing power and interest rate risks. Furthermore, during recent years savings accounts and CD's have provided better yields and the difference in financial risk is minimal. Ease of purchase through payroll deduction plans is probably the primary reason Series E and Series H bonds are purchased.

Money Market Instruments

As stated earlier, the term "money market" applies to the market where short-term securities are traded. Among a vast number of security issues trade din the money market, the most important securities to investors asre the United States Government Treasury bills.

Treasury bills originate at weekly auctions where they are sold at a discount from their face value. Bills usually have maturities of 91 or 182 days although there are times when the Treasury issues bills having maturities as long as one year. Since Treasury bills are actively traded in the money market it is possible to purchase bills having maturities as short as one day.

Readers of Treasury bill quotations in financial publications often are confused because the bills are quoted on a yield basis which means that the bids are larger than the asks, whereas stocks and bonds are quoted with asks larger than bids. It should be remembered that an inverse relationship exists between yields and prices.

The yields being received by buyers of Treasury bills at a specific time exert tremendous influence on the actions of bankers and others who extend credit. When Treasury bill rates are low, bankers are more eager to make consumer loans that when Treasury bill rates are high. The Federal Reserve System (in there open market operations) exerts influence on the yields available on Treasury bills.

Since Treasury bills are considered to have less financial risk than any other security and, since they are short-term and therefore have little interest rate risk, many individuals consider them to be better than money because they earn interest and money does not. They are usually issued in large denominations, although they are available in denominations as low as $1,000. Your banker can help you with purchases should you decide to include Treasury bills in your secondary reserve.

Other money market instruments include short-term notes, bankers acceptances, Federal agency and tax-exempt notes having maturities less than one year, commercial paper, and certificates of deposits, discussed earlier. Usually money market instruments are in large denominations and therefore are not of great interest to most individuals for use as part of their secondary reserve.

Summary

Extensive fluctuations which have occurred since the mid-1960's negate the wisdom of purchasing long-term securities and putting them in a lock box. Losses have been sustained by both buyers of common stocks and bonds, especially when sales have had to be made during depressed markets.

To protect against losses which result when securities have to be liquidated at depressed prices, it is recommended that a secondary reserve be made up of short-term securities and savings instruments. The size of the secondary reserve would be expanded and contracted based on expected future developments in the security markets. This article has centered attention on savings accounts and short-term securities to use in creating the recommended secondary reserve. A future article will explore the investment possibilities in long term issues.

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Small Business

Liquidation of A Small Corporate Business

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In a recent issue of the Woman CPA, we discussed the pros and cons of incorporating a small business. We would do our clients a disservice if we did not point out to them that there may be some unexpected tax consequences when the corporate owner, some years down the road, decides that it is time to get out of business. He/she can, of course, sell the stock to a new corporate owner, and the tax result is usually long-term capital gain on the difference between the cost of the stock and the proceeds from the sale. This is sometimes done, but much more frequently by the owners of large corporations than by owners of small corporations with one or a few stockholders. There is often not a ready market for the stock of a small corporation, and the owner is faced with the necessity to liquidate the corporation.

Let's take a look at the tax cost of this procedure.

From the corporation's point of view, distribution of assets to shareholders results in no recognized gain, regardless of method of liquidation, with the following exceptions:

(a) Recapture of depreciation on disposition of tangible and intangible personal property and of real property and leaseholds results in ordinary income to the distributing corporation.

(b) Installment obligations received on the sale of corporate assets and their distribution in liquidation trigger taxable income to the corporation (Sec. 453 (d) Internal Revenue Code). The amount of the gain to the corporation is the unrealized profit on the installment obligation at the time of liquidation. This rule does not apply to corporate liquidations under Sec. 337 (sale of property during twelve-month-liquidation), but it does apply if the sale was made prior to the election under Sec. 337.

Investment credit must generally be recaptured by the corporation at time of liquidation if the investment credit has not yet been earned.

From the stockholders' point of view, the general method for liquidating a corportation — Section 331 IR Code — works as follows: The corporate assets are exchanged for the outstanding stock of the corporation. Under the general rule, the distribution in liquidation is treated, in effect, as a sale of stock from the stockholders to the corporation. Gain or loss on distribution in complete liquidation is a capital gain or loss. The capital gain or loss is short-term or long-term depending on the holding period of the stock by the stockholder.

The recipient of the liquidating dividend will be taxed on the gain. Unless a substantial portion of the assets received are cash or other liquid assets, the recipient may have a problem in meeting his/her tax obligation. Often stockholders of closely-held corporations have most of their funds invested in their corporation and have few other resources for the payment of taxes. This situation points up the need for relief provisions.

Liquidation under Section 333 (One-month liquidation)

Section 333 of the IR Code provides relief as to the non-recognition of gain under certain conditions for one-month liquidations of corporations. Provisions of the Code and Regulations must be strictly followed or the relief will be denied and the provisions of Section 331 will be applied, normally at considerable tax cost to the stockholder.

A one-month liquidation under Section 333 must be accomplished within one calendar month. It is, therefore, advisable to adopt the plan of liquidation on the first of any given calendar month or as soon thereafter as possible in order to complete the liquidation on or before the last day of the same calendar month. Do not elect on June 15 and complete the liquidations before July 15! It won't work. If you elect in June, you must complete the liquidation in the same month of June.

The one-month liquidation can be advantageous when the following conditions are met:

(1) Liquidating corporation is holding appreciated property;

(2) Liquidating corporation has little or no earnings and profits or cash and securities acquired after 12-31-53.

What is taxed to the recipient stockholders in the case of a one-month liquidation?

(1) Retained Earnings are taxed as ordinary dividend.

(2) Cash and securities acquired after 1953 are taxed as a long-term or short-term capital gain depending

upon the period of time the capital stock was held by the stockholders.

(3) The other assets received in liquidation result in no recognition of gain to the stockholders upon receipt of the liquidating dividends.

The following is the balance sheet of a corporation prior to liquidation:

Cash and securities acquired after 1953	$20,000
Unimproved real estate (FMV $90,000)	17,500
	$37,500
Capital stock outstanding	$25,000
Retained Earnings	12,500
	$37,500

Assuming that stockholders' basis in the stock is $25,000, they will be taxed as follows under Sec. 333 for one-month liquidation:

Long-term capital gain on cash and securities one-half of $20,000	$10,000
Ordinary income on Retained Earnings	$12,500
Total amount Taken into income	$22,500

Under the regular method of Section 331, stockholders' gain would have to be computed as follows:

Assets received at FMV:	
Cash and securities	$20,000
Unimproved real estate	90,000
	$110,000
Less stockholders' basis in stock	25,000
Long-term capital gain	$85,000
Taxed at one-half	$42,500

This is $20,000 more than under the one-month liquidation. For the purpose of this illustration, we are ignoring the minimum tax rules except to mention that they would make it even more advantageous to liquidate under Section 333, rather than Section 331.

The basis of property received in a one-month liquidation is computed as follows:

Basis of capital stock redeemed or canceled in liquidation	$25,000
Less cash received	20,000
	$5,000
Plus total amount of gain:	
Ordinary	12,500
Captial	20,000
	$37,500

The procedure to qualify for a one-month liquidation is, briefly, as follows:

(1) Form 964 must be filed with IRS by each qualifying electing shareholder within thirty days after the adoption of the plan of liquidation.

(2) Form 966 must be filed with the IRS by the corporation within thirty days after adoption of the proposed plan of liquidation.

(3) Forms 1099L (with transmittal form 1096) must be filed with the IRS for each shareholder receiving a liquidating dividend or distribution of $600 or more. The due date for these forms is February 28 of the year following the calendar year in which the distribution in liquidation occurred.

(4) Legally dissolve the corporation under the laws of the state of incorporation for the firm.

Liquidation under Section 337 (twelve-month liquidation)

Prior to the enactment of the IR Code of 1954, if a corporation sold its asset at a gain and then distributed the proceeds to the shareholders in complete liquidation, the sale and the distribution would result in a double tax. The corporation would first pay a tax on the recognized gain on the sale, and then the stockholders, upon receipt of the proceeds in the liquidation of the corporation, would be liable for a tax on the difference between the amount received in liquidation and the basis of the capital stock investment.

The procedures under Section 337 are as follows:

(a) Adopt Plan of complete liquidation;

(b) Within 30 days after the adoption, file Form 966 with the IRS;

(c) Within the twelve-month period beginning on the date of the adoption, all of the assets of the corporation are distributed in complete liquidation (less assets retained to meet payables).

If these conditions are met, no gain or loss will be recognized to the corporation from the sale or exchange by the corporation of its property within the twelve-month period. However, under the depreciation recapture provisions of Sections 1245 and 1250, if these sections are applicable to the sale and liquidation under Section 337, they will result in ordinary income taxable to the corporation equal to the depreciation recapture.

Let's again use the balance sheet previously shown and work out the tax consequences.

The corporation is to be liquidated after the sale of real estate for $90,000 cash. Without the relief provisions of Section 337, the corporation has a long-term capital gain of $72,500 which results in tax liability of 30 percent.

Subsequently, assets distributed to stockholders would be as follows:

Cash on hand prior to sale of real estate	$20,000
Proceeds from sale of real estate	90,000
	$110,000
Less Federal income tax	21,750
	$ 88,250
Assuming again that the basis of the stock to the stockholder is	25,000
the long-term capital gain	$63,250

The tax on one-half of $63,250, or $31,625, is $8,514 if we assume that the stockholder is married, files a joint return and the $31,625 is his/her taxable income. After the liquidation of the corporation and the payment of the personal income tax, the former stockholder has $79,736 left, the $88,250 which came to him from the corporation, minus the $8,514 income tax paid on the disposition of his stock.

Under Section 337, the corporation does not recognize the gain on the sale of real estate, and the stockholder would, therefore, receive the following amounts:

Cash on hand prior to sale of real estate	$ 20,000
Proceeds from sale of real estate	90,000
	$110,000

The taxpayer would be taxed on the long-term capital gain of $85,000 — the difference between $110,000 cash received and $25,000 basis of stock. The tax on one-half of $85,000, or $42,500, would be $13,340 for a married taxpayer filing a joint return.

Thus, after paying the income tax, the former stockholder would still have $96,600 — $110,000 received in liquidation minum tax of $13,340.

The $96,600 retained under a Section 337 liquidation is $16,864 more than the $79,736 retained under the regular method of liquidating. Again, for the sake of simplification, we have ignored the rules of minimum tax.

To summarize: when stockholders of a small corporation want to retire from business or get out of business for some other reason, they may find it difficult to find a ready market for their stock. They may then decide to liquidate their corporation. If they do this, it is advisable that they obtain expert advice regarding the method of liquidation. The method chosen and the proper procedure of liquidating may make a great deal of difference in the amount of after-tax dollars retained by them.