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Constance T. Barcelona

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Mississippi State University
P.O. Drawer EF
Mississippi State, Mississippi 39762

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P.O. Box 39295
Cincinnati, OH 45239
Phone: 513-385-3998

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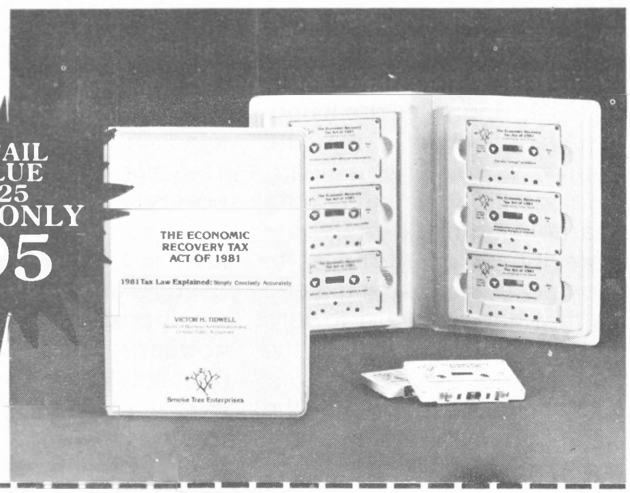

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about the author:

Victor H. Tidwell

- Doctor of Business Administration and Certified Public Accountant
- Tax professor at one of the nation's largest colleges of business . . . has taught for over 20 years
- Co-author of leading tax text used in many colleges and universities . . . author of numerous journal articles
- Past President of the American Taxation Association and member of American Institute of CPA's
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Editor's Notes

A seasonal wonder

This week the kites are fluttering, dipping, then zooming ever higher, flaunting their gaudy streamers as they soar above the grey gulls which fly so purposefully, back and forth, up and down, over the edgewater at Daytona Beach. Wet sand smacks at the bare feet of children, their fond parents, and collegians, all running along the beach and maneuvering their kites to take advantage of every gust and whip of sea wind. The blue southern sky is streaked with the colors of kites, but kites are flying under northern skies too, where the blue is more tenuous or misty, or perhaps just a windy grey. This week, wherever it is Spring, kites are flying.

What rush of relief from the enclosures of winter; what a heart-lifting ritual of flight and reaching up. Inseparable from the body, the hand is gravity locked to the earth but the string with the kite at the end of it pulls that hand upward toward the sky, perhaps even hinting at the tug of heaven.

Flight is freedom, or at least the illusion of it. Icarus, that unfortunate dreamer, had replicas of wings fastened to his back with wax and then flew toward the sun, but the heat from the sun melted the wax so that the wings slid away and left Icarus to fall drowning into the sea. A tragic story, but one tinged with romantic sadness because everyone knows that urge to be up and away from the mundane. Kites become our surrogates. If they tangle in a treetop or plummet down between buoyant puffs of wind, the loss is only one of pride and petty cash.

Of course the dreamer populations always has a few members who hitch practicality to the fluttering tails of their kites. Benjamin Franklin was one of those, and so were Dr. Alexander Wilson and Thomas Melville, two Scottish scientists who, in 1749, attached a thermometer to their kites and thus recorded temperatures high above the earth. Others of inventive turn of mind have dedicated themselves to the improvement of kite structures.

England's Captain Baden-Powell managed to hoist himself in the air by a tandem of five kites and, unlike poor Icarus, returned to earth all in one piece. When one considers the financial ill-wind that is buffeting the airlines of American, a tandem of kites seems almost practical.

The young-at-heart sometimes take kite flying very seriously, and along the way demonstrate that children of any age can be the most creative thinkers. Meteorological observations are carried on continuously be the U.S. Weather Bureau kites, even though satellites have enjoyed latter-day fame as weather observers. At Viborg in the northern part of Denmark a permanent station for kite flying includes a thirty-foot high tower that can be rotated on rails, with one side left open. The wind may blow from north, south, east, or west but the opening can be turned leeward so that the operator can sit snugly inside with the windlasses and watch the kites careening out and up.

Kites have been used to throw lines across chasms or carry life lines to distressed ships, all before the days of helicopters. For the intrepid, hang gliding improves greatly on the venture of Icarus. Like colorful batmen, hang gliders float as part of giant kite along the air currents. Consider how many trial kites crashed to earth before hang gliding became feasible (if not completely reassuring) for humans, or for that matter, how many thousands of kites tested the wind while the observers learned about aeronautics.

Even the staid accounting profession flies a figurative kite now and then when the Financial Accounting Standards Board floats a new Discussion Memorandum over its constituency. Discussion Memos do not all fly high, or even in a straight line, but their launching leads to instruction. Like kite flyers on a breezy Spring day, accountants keep trying for the right interpretation of which way the wind is blowing and the successful navigation of troublesome cross-currents.

Most happily, the sight of kites can make children of us all. A kite flyer running across the beach, or meadow, or playground is the very symbol of a free spirit. And as befits this happy aura, kites are treated as art forms, especially by the Japanese who have crafted high-flying dragons and birds and butterflies.

Kites are a seasonal wonder, with a reminder that every season, any season, is the right time to try to fly something just for the fun of it. There is no guarantee that the results will be as electrifying as Ben Franklin's, but then, with a lucky turn of the wind something new and wonderful just might come of it.

Constance T. Barcelona

Capitalizing Interest Costs

A Closer Look

By Louis P. Ramsay

In October 1979, The Financial Accounting Standards Board (FASB) issued its Statement of Financial Accounting Standard No. 34, "Capitalization of Interest Cost."[1] Except for some isolated situations such as the accounting practice in the regulated utility industries, it has been a conventional accounting practice to account for interest costs as period costs which are expensed against revenues of the accounting period. When interest rates were much lower than they have been over the past decade or so, expensing interest as incurred may well have been viewed as appropriate because it led to conservative income measurement and often was not a material element in income determination. Lately, however, an increasing number of firms found it desirable to capitalize a portion of their interest costs. This is attributable to more business firms raising debt capital to finance their operations due to the tax deductions on interest and the impact of inflation on future payments. Another factor influencing capitalization is the dramatic increase in corporate debt interest rates. Becoming alarmed by the discernable trend of interest capitalization, the Securities and Exchange Commission imposed a moratorium on the adoption or extension of this practice in 1974 through the issuance of Accounting Series Release No. 163, "Capitalization of Interest by Companies Other Than Public Utilities."[2]

The Financial Accounting Standards Board took on the challenge of ASR No. 163. SFAS No. 34 resulted from FASB's deliberations which reflect drastic departure from the conventional accounting practice.

The FASB issued an *Exposure Draft,* "Capitalization of Interest Cost in Financial Statements that Include Investments Accounted for by the Equity Method" on September 30, 1981. The major thrust of the draft was to include investments in other companies accounted for by the equity method as a qualifying asset for interest capitalization. This is a logical extension of the definition of qualifying assets inasmuch as investments in other companies are income oriented as are plants being constructed for the investor. The draft states that interest incurred on the investment up to the date the investor commences its planned principal operations should be capitalized. This type of asset should qualify for the interest capitalization.

This paper basically supports the tenets reached in SFAS No. 34; however, it behooves the reader to note that certain conceptual problems remain embodied within the Statement. These shortcomings are noted along with their suggested solutions. To facilitate subsequent discussions, relevant provisions of SFAS No. 34 are first summarized below, followed by observations on their potential impact on financial accounting and reporting, and by comments on the more fundamental, conceptual issue of interest capitalization.

Highlights of SFAS No. 34

Pertinent requirements of FASB Statement No. 34 are summarized below:

1. *Qualifying Assets* — To qualify for interest capitalization, assets must require a period of time to get them ready for their intended use. Qualifying assets are assets that an enterprise constructs or produces for its own use (such as facilities), and assets that are constructed as discrete projects and intended for sale or lease (such as ships or real estate projects). Investment in other companies that are in a pre-operating status and are being accounted for by the equity method are also qualifying assets. Interest capitalization is required for those assets if its effect, compared with the effect of expensing interest, is material.
2. *Eligibility for Capitalization* — The interest cost which is eligible for capitalization includes any of the following:
   a. Interest on obligations having implicit interest rates.
   b. Interest imputed in accordance with APB Opinion No. 21, "Interest on Receivables and Payables."
   c. Interest related to a capital lease as per FASB Statement No. 13, "Accounting for Leases."

   The total amount of interest cost capitalized in an accounting period shall not exceed the total amount of interest cost incurred by the enterprise in that period.
3. *Capitalization Rate* — The capitalization rates shall be based on rates applicable to borrowings outstanding during the period. If a specific borrowing is related to an asset under construction according to the financing plan, the enterprise may use the rate associated with that specific borrowing as the capitalization rate, up to the amount of that borrowing. Otherwise, a weighted average rate shall be used. The capitalization rate is to be applied to the average amount of accumulated expenditures for

Table 1

Effect of Interest Capitalization on Income Statement

	Income Statement(s) for Period(s) Prior to Use or Sale of Asset	Income Statement(s) for Period(s) Of Use or Sale of Asset	Income Statements During Asset's Lifetime
Cost of sales/depreciation	—	Increase	Increase
Interest expense	Decrease	—	Decrease
Provision for income taxes	Increase	Decrease	None
Net income	Increase	Decrease	None

Source: FASB Discussion Memorandum, 1977, p. 48.

the asset under construction during the period.

4. *Capitalization Period* — Capitalization shall begin when all of the following conditions exist:
   a. Expenditure for the asset has been made.
   b. Activities to get asset ready are in progress.
   c. Interest cost is being incurred.

   Interest capitalization is to cease when the asset under construction is essentially complete and ready for its intended use.
5. *Disclosure* — The amount capitalized and the total amount of interest payments during the accounting period shall be disclosed.
6. *Effective Date* — The Statement shall be applied prospectively in fiscal years beginning after December 15, 1979, and shall not be applied retroactively for previously issued annual financial statements.
7. *Exemption* — The regulated industries are exempted from the requirements of this Statement, pursuant to the Appendix to APB Opinion No. 2.

Impact on Financial Accounting and Reporting

Recording interest as an acquisition cost of an asset will affect both the balance sheet and the income statement. Due to the inclusion of interest as an element of the cost of acquisition, the amount reported for qualifying assets would be higher than what would be the case under the current practice. Thus, the associated financial position ratios will be effected.

The income statement is also affected because the reported earnings would be affected. SFAS No. 34 has the effect of deferring an item of expense to future charges against future revenues. Over a long period of time, the difference between charging the interest cost directly to expense, on the one hand, and adding it to the cost of assets and increasing depreciation expense, on the other hand, would have little aggregate effect. But the short-run effect on periodic income could be significant. Since financial statements are prepared on a periodic basis, the short-run effect has great importance. As noted in a subsequent paragraph, it would appear that SFAS No. 34 presents increased opportunities for manipulation of reported earnings.

Table 1 summarizes the income statement effect of capitalizing debt interest as presented in the FASB Discussion Memorandum on Accounting for Interest Costs.[3]

According to Sec. 226 of the 1954 Internal Revenue Code, interest and taxes may be capitalized as an asset cost for certain real and personal property. However, the taxpayer has the choice to deduct the interest or capitalize it. In most cases, the former would be chosen, and the cash flow for tax payments would remain unchanged from circumstances existing prior to SFAS No. 34. Thus, the resulting economics of SFAS No. 34 have a negligible effect upon cash flow but a noticable impact on reported financial information.

SFAS No. 34 does not require retroactive application of interest capitalization. The effect of not requiring retroactive application is most noticable in the earlier years, especially in the year of adoption of the Statement. A drastic increase in earnings per share is made possible by a mere change in the accounting treatment of interest costs. This effect is to be expected, since costs of operations during the transition period are understated based on the provision of SFAS No. 34 to capitalize interest costs only on a prospective basis. Annual reports of business enterprises showing "windfall profits" may be anticipated for the first few years after SFAS No. 34 becomes effective. By not allowing retroactive treatment, those enterprises which previously did not capitalize interest will reflect lower charges to earnings (since capitalized interest is not included in the assets being depreciated or charged-off at the point of sale) than enterprises which previously capitalized interest. Thus operating results will not be comparable until there has been a sufficient passage of time to reduce the impact of the non-capitalization practice which existed prior to the effective date of the FASB Statement 34. To correct this lack of comparability, it is recommended that the Statement be applied on a retroactive basis. It should be noted that the SEC's moratorium of 1974 did not prohibit companies which had publicly disclosed their interest capitalization practice from continuing such a practice.

The extent of the impact of interest capitalization on reported earnings is somewhat related to the relative levels of capitalized interest and of earnings before taxes. As might be expected, a small business enterprise with modest earnings will show a major increase in earnings per share if it undertakes a major expansion program via debt funding. This points out an opportunity for an enterprise to manipulate its earnings figure by potential abuses of the provisions of SFAS No. 34. It seems to provide incentive for an enterprise to modify its existing financing policy. A company with sufficient funds to finance a project may elect to borrow so that the interest on debt could be capitalized and the available funds could be invested to generate income.

It is felt that there are several areas in which problems related to the application of SFAS No. 34 may arise. These are individually addressed in the following section. Although these weaknesses do exist, they can be corrected. Once corrected, the Statement will give added useful information.

Potential Problem Areas

Qualifying assets are defined in SFAS No. 34 as those intended for an enterprises's own use or for sale/lease. There is no guidance as to how to allocate interest cost if assets are being constructed both for sale and for own use, and if the total amount of qualifying assets exceeds the amount of borrowings. For example, suppose the enterprise borrows $1,000,000 to partially finance the construction of a $1,000,000 asset for its own use and another $1,000,000 asset for sale. If the interest cost is allocated to the asset being constructed for its own use, the effect on the income statement would be substantially different from that which would exist if the interest cost is allocated to the asset intended for sale. The company's own asset would be depreciated over its useful life, and the interest would be recognized as expense over this period. On the other hand, interest capitalized in an inventory item would be expensed as soon as the asset is sold. Similar allocation problems may arise if there are several different assets being constructed during the same period. The allocation can be very subjective. The allocation process must be based on some objective basis. One such approach could be a weighted average percentage of all assets being constructed during that time period. This is comparable to the allocation of joint costs on a relative sales value basis.

One of the conditions necessary for initiating and continuing the capitalization period is that activities that are necessary to get the asset ready for its intended use must be in progress. According to SFAS No. 34[4]:

> "The term activities is to be construed broadly. It encompasses more than physical construction, it includes all the steps required to prepare the asset for its intended use."

Given this definition of the term "activities," it is conceivable that an enterprise could undertake certain activities which are relatively superficial in nature, yet which may be argued as "steps required to prepare the asset for its intended use," thereby extending the capitalization period while in effect the asset is on a holding pattern. It would seem that the FASB must specify what activities qualify to meet the conditions of the paragraph. If this is not done, too much latitude exists for the firm doing the construction. The independent CPA will be faced with the problem of interpreting this rule which will lead to variations in implementing the Statement.

If an enterprise's financing plan associates a specific borrowing with a specific qualifying asset, the rate of this specific borrowing may be used as the capitalization rate. A weighted average rate of other debt would be applied to the amount of expenditures for the qualifying asset in excess of the specific borrowing. There are a number of problems associated with these provisions of SFAS No. 34.

First of all, the association of debt with assets appears to be a subjective basis for objective accounting. The results of an enterprise's operation may be altered at management's discretion by adjusting the financing plan. Borrowed funds originally intended for operational needs could be diverted to qualified asset procurement and the interest could be capitalized rather than expensed. Thus, to avoid the opportunity for manipulation, it would appear that interest costs incurred during construction periods should be capitalized, regardless of the use of the debt funds. The interest could be allocated using the weighted average percentage basis mentioned earlier.

SFAS No. 34 allows considerable latitude in determining the weighted average rate. For example, all borrowings of a parent company and its subsidiaries may be included in arriving at the weighted average rate. It is questionable that this combination reflects the economic reality of the borrowing rate because the rate for each subsidiary is dependent upon factors peculiar to each firm. Any combination of debt selected from these borrowings is also permitted. The pick-and-choose procedure allowed by SFAS No. 34 is a subjective one, and is potentially capable of being abused to manipulate reported earnings.

Furthermore, the use of a weighted average rate seems to be based on the premise that funds are fungible. On the other hand, funds are considered traceable in SFAS No. 34 because specific debt may be associated with particular assets. Thus, funds are both fungible and traceable — an apparent contradiction.[5]

It is a matter of fact that debt for any purpose cannot be isolated from other obligations of the enterprise. The rate of interest on a specific borrowing will reflect the overall capital structure of the enterprise. Additionally, most large construction projects are supported by various sources of corporate funds which are in constant flux. It would seem logical and practical, therefore, to use as the capitalization rate the average cost of all obligations of that particular entity which give rise to interest costs for the entire period.

In some cases excess funds borrowed for a specific purpose are invested to earn income until the time they are needed for the specific purpose for which they are borrowed. The question of whether this interest

Problems exist in allocation of construction interest costs, and in qualifying assets.

Interest capitalization produces a significant short-run effect on financial position ratios.

income should be offset against interest expense in determining the amount of interest cost available for capitalization is not addressed in SFAS No. 34.

On December 22, 1981, the FASB issued an *Exposure Draft* entitled "Capitalization of Interest Cost in Situations Involving Tax-Exempt Borrowings and Certain Gifts and Grants," as an amendment of FASB Statement No. 34. The proposed conclusions of the Board are that:

1) When proceeds of tax-exempt borrowings are temporarily invested, the capitalized cost of the borrowings shall be decreased by any interest earned on related interest-bearing investments from the date of the borrowing until the asset is ready for its intended use.
2) No interest cost will be capitalized on the portion of a qualifying asset acquired with a gift or grant that is restricted by the donor or grantor to acquisition of the specified asset. Interest earned on temporary investment of those funds that is similarly restricted will be considered an addition to the gift or grant.

Another minor issue concerns the impact compensating balances have on the effective interest cost of borrowed funds. It is clear that a requirement to maintain compensating balances increases the borrowing's effective interest rate, and this cost should be included in determining the capitalization rate.

Conceptual Issue of Interest Capitalization

Capitalization of interest cost is a controversial issue, and opinions differ within the accounting profession and within the FASB as to how best to treat the element of interest in financial accounting and reporting. SFAS No. 34 was adopted by a vote of 4 to 3, with the Chairman of the FASB voting against it[1]

This author concurs with the conclusion reached by the majority of the FASB Board. The concurrence is based on practical grounds rather than conceptual logic.

Ideally the acquisition cost of an asset should include all costs incurred to place that asset in a condition suitable for its intended use. The cost of capital employed during the period of construction of an asset is as much a part of its cost as the cost of materials, labor and allocated overhead. This view is consistent with the concept of historical cost, a fundamental accounting principle. It is also in line with the economist's view that cost of capital is a cost of assets.

Given the constraints of the historical cost accounting model, the issue germane to this section of the paper concerns how to best account for cost of capital. There are three options:[6]

a. Capitalize interest on debt and imputed interest on equity.
b. Capitalize interest on debt.
c. Capitalize nothing; expense interest on debt as period cost.

The pros and cons of each of these options have been amply documented in the FASB Discussion Memorandum, and they will not be repeated here.

Of these options, only the first one is conceptually sound and in accord with the economic facts. The FASB adopted the second option as a compromise between the conceptually sound accounting alternative and the limitations of the present accounting model. This author agrees with that decision, and the basis for agreement will be mentioned later. The three dissenting members of the FASB elected the third option, which was the current practice.

If the cost of capital were not capitalized, it would not be possible to properly match costs with related revenues. Charging the costs of capital to expense would ignore the fact that the costs were incurred to generate future revenue, not to sustain current operations. Additionally, immediate charge-off would cause future earnings to be inflated because the interest costs associated with the future revenue would have been expensed in earlier periods. Thus, the current practice of expensing all interest costs is conceptually incorrect and might be modified; however the practical significance of this proposed change is questionable, and reference is made to this in a subsequent paragraph.

In recent years, two notable figures in the accounting profession have spearheaded a movement aimed at adopting the first option stated above. Because of the failure to recognize the cost of capital as an element of acquisition cost, "present financial accounting does not reflect economic reality. Worse than that, it creates an illusion of enormous profits where often no true profit exists, thus making some corporations look far better than they really are."[7] Without recognizing the cost of equity capital, "a capital acquisition could actually cause a decrease in the profits reported for the early years after the asset became productive, even though the profit center was in fact more profitable."[8] In this respect, it is noted that managerial accounting does impute the cost of capital in investment decision models which generate economic information for internal use. Users of financial statements, however, would not formally have access to such information.

According to Paragraph 41 of the Exposure Draft in which the FASB expressed its majority view, "a valid conceptual argument exists for basing capitalization of interest on enterprise cost of capital which would include imputed interest on equity capital as well as interest on borrowed capital."[9]

Nevertheless, an imputed rate of interest must be determined and this rate is not readily determinable based on recorded transactions within the present accounting framework. Practical difficulties impede the implementation of the concept of capitalizing the cost of equity capital. Furthermore, it would not be proper to base the imputed cost of equity capital on the exchange prices when equity securities were issued because such an imputed value would not fairly represent the cost of equity funds employed in the current asset construction project.[10]

The utility industry has been allowed to impute cost of equity for capitalization purpose for more than half a century; however, this industry still does not agree on a "definite standard and related methodology as to how the rate for capitalization of interest during construction should be developed."[11]

The reason for the continuing controversy in the utility industry is attributable to "attempts by the regulatory agencies to apply a narrow interpretation to the term 'interest' and otherwise to limit the amount that a utility may rightfully categorize as 'interest during construction'."[12] The matter remains unsettled for the regulatory utility industry.[13]

Anthony, who advocates the practice of capitalizing cost of equity, also recognizes the practical aspects of implementation. He suggested, however, that it is better to be "approximately right than entirely wrong."[14] Namely, it is better to estimate the imputed cost of capital than to omit this cost simply because the amount cannot be measured precisely.

This author does not agree with such a view because the current historical cost model does not provide for imputed equity interest capitalization. Furthermore, there is an empirical finding which tends to support the FASB's decision to not require capitalization of the cost of equity capital.[15] The investigation determined the effect of accounting recognition of cost of equity on the relationship between earnings per share and stock returns. Compared to the association between the conventional earnings per share and stock returns, recognizing the imputed cost of equity would result in a weaker association. The message seems to be that information based on recognition of equity cost does not have much practical significant relevance to the investor's decision making. Inasmuch as the marketplace attributes negligible significance to equity interest capitalization, it would seem a violation of the cost/benefit rule to require this type of disclosure. Thus, the conclusions reached by the FASB appear to be supported from a practical viewpoint.

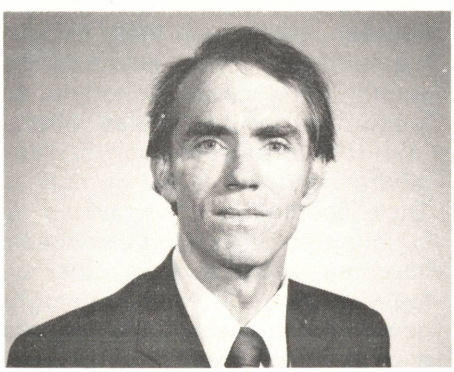
Conclusion

SFAS No. 34 embodies a compromise between the sound accounting concept of recognizing the cost of capital as an element of an asset's acquisition cost, and the practical limitation of the historical cost accounting framework which prohibits recording the cost of the equity capital. A number of implemental issues are raised in this paper. However, the issues are not insurmountable. The following are recommended to overcome the identified potential problem areas:

a. Consideration should be given to apply SFAS No. 34 on a retroactive basis so as to minimize the impact on financial statements during the transition period.
b. The interest cost should be allocated among qualifying assets in proportion to the level of expenditure for each asset.
c. Superficial "activities" should not be permitted to justify the initiation or continuation of the capitalization period.
d. The capitalization rate shall be the weighted average cost of all obligations of the specific enterprise.

As opposed to a mass of rules to provide for every possible practical situation, SFAS No. 34 includes broad guidelines to be used in capitalizing interest costs in conformity with the principle of matching costs with revenues. The Board has applied cost/benefit considerations which resulted in workable rules to provide material information for better reflecting the economic reality of business enterprises. This information should be useful to potential users of financial statements; however, it is up to the accounting profession to persuade potential users of financial statements of the fact that SFAS No. 34 is indeed proper and justifiable. Ω

The utility industry still debates standards for capitalizing interest on equity.



Louis P. Ramsay, CPA, D.B.A., *is associate professor of accounting at Clemson University in South Carolina. He has been affiliated with Peat, Marwick, Mitchell & Co., and with the faculty of Eastern Michigan University, and SUNY at Fredonia. He is a member of American Accounting Association.*

NOTES

1 Statement of Financial Accounting Standards No. 34, "Capitalization of Interest Cost," FASB, Stamford, Conn., October, 1979.

2 Accounting Series Release No. 163, "Capitalization of Interest by Companies Other Than Public Utilities," Securities Exchange Commission, Washington, D.C., 1974.

3 Discussion Memorandum, "An Analysis of Issues Related to Accounting for Interest Costs," Financial Accounting Standards Board, Stamford, Conn., December 16, 1977.

4 SFAS No. 34, op. cit., para. 17.

5 Discussion memorandum, op. cit.

6 Ibid.

7 P. L. Defliese, "What Makes Profits Look 'Obscene'," *Business Week*, August 4, 1975, pp. 10-11.

8 R. N. Anthony, *Accounting for the Cost of Interest*, Lexington Books, Lexington, Mass., 1975, p. IX.

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Female And Male Accounting Students

Managerial Ability and Professional Attitudes

By E.A. Cumpstone, Bruce R. Dixon and David B. Taylor

An increasing number of women are studying business subjects at tertiary level. In particular, this has been evidenced by the number of women studying accounting at an undergraduate level. For example, of students graduating with a Bachelor of Management Studies degree at the University of Waikato, in Hamilton, New Zealand, the proportion of females majoring in accounting has more than doubled from 4 percent in 1977 to 9 percent in 1979 and the trend is continuing.

This situation has created some interest as to the type of personality and academic ability of women who are choosing accountancy as a potential career. In particular, this interest has focused on how women compare with their male colleagues on various characteristics. For example, a study comparing the personality factors of female and male articled clerks undertaken by Osman [1973] concluded that "in personality it seems that women articled clerks are as good as their male colleagues." Pfeifer and Shapiro [1978] in a survey of female and male M.B.A. students at Montreal universities using the Californian Psychological Inventory Test found that only minor differerences existed. The article concluded, "As for the belief that women have different personalities that disqualify them for responsible executive positions, let's just dismiss that myth as an 'old husband's tale.' "

Recently in this journal Fraser et al. [1978] compared the academic performance of female and male accounting majors, and found that women performed somewhat better than males in undergraduate accounting courses. They also examined personality differences between female and male accounting students using Edwards Personality Preference Schedule and found that of the fifteen characteristics measured significant differences were found on only six. They concluded, "Women in accounting do differ however, in some important respects from other college women. They have higher needs for achievement and for order, and have more endurance relative to other college-age women. These traits would seem desirable for jobs in public accounting."

The purpose of this paper is to compare the managerial ability of female and male accounting students and also their respective attitudes towards the accounting profession.

Managerial Ability

As accounting is often used as a method of entering the managerial ranks, employers and those involved in staff or personnel development should be aware of the managerial talents of accounting students. Such information would assist employers to place females and males in positions that would capitalize on their particular managerial strengths. Similarly staff development should build upon those strengths while assisting in the elimination of weaknesses.

The Self-Description Inventory developed by Ghiselli [1971] was used as the research instrument to determine the managerial traits of female and male accounting students. The Self-Description Inventory is a measure which has been shown to relate characteristics of individuals with managerial success. Respondents complete a questionaire in which they have to select from 64 pairs of words, 32 adjectives they feel describe them favorably and 32 adjectives which they feel describe them unfavorably.

The responses are scored against thirteen managerial traits which play varying roles in determing managerial success. The managerial traits are divided into three classifications, managerial abilities, personality traits, and motivations. Table 1 details the traits and Table 2 lists their importance in regard to managerial talent.

The Ghiselli measure has been used in a number of studies determining the managerial talent of managers from various functional backgrounds, for example, personnel, financial, production, and marketing managers. [Miner & Miner, 1976] [Elliott & Margerison, 1977].

Studies have also compared the results obtained using the Ghiselli measure with different groups; for example, Elliott and Margerison [1977] compared the results of marketing managers to managers in other fields including personnel, production, finance and administration. Miner [1976] compared the results of managers to those of students while Taylor and Dixon [1980] have compared the results of marketing students to other management students.

A total of 198 accounting students in the School of Management

TABLE 1

Personality Measures of Managerial Talent

CLASSIFICATION	MEASURE	DEFINITION
Measures of ability	Supervisory ability	The capacity to direct the work of others, to organise and to integrate their activities so that the goal of the work can be attained.
	Intelligence	The capabilities of judgment and reasoning and the capacity to deal with ideas, abstractions and concepts.
	Initiative	The capacity to begin action, to act independently and to see courses of action not readily apparent to others.
Measures of personality traits	Self-Assurance	The extent to which an individual perceives himself to be effective in dealing with the problems that confront him.
	Decisiveness	The willingness to make a decision.
	Working class affinity	The degree to which a person has a feeling of kinship and understanding with people "on the shop floor."
	Maturity	The state at which the processes of development are complete so that there is no further natural growth or improvement.
	Masculinity/ Femininity	The manifestation of traits, perceptions or other qualities associated with the opposite sex.
Measures of motivational traits	Achievement motivation	The level of occupational attainment the individual seems to be striving for.
	Self-actualisation	An indication of the extent to which the individual needs and wants to use his talents to the fullest.
	Job Security	The need to be protected from adverse conditions or circumstances.
	Need for high financial reward	The extent of an individual's desire to monetary gain from work.
	Need for power	The need to seek positions and circumstances where an individual can direct and control the activities of others.

TABLE 2

Personality Measures and Their Importance In Relation To Managerial Talent

Classification	Measure	Importance Value[a]
Measures of ability	Supervisory ability	100
	Intelligence	64
	Initiative	34
Measures of personality traits	Self assurance	62
	Decisiveness	61
	Working class affinity	47
	Maturity	5
	Masculinity/femininity	0
Measures of motivational traits	Achievement motivation	76
	Self-actualisation	63
	Job security	54
	Need for high financial reward	20
	Need for power	10

[a]Importance value 100 = very important
0 = plays no part in managerial talent

Source: Ghiselli

TABLE 3

Mean Scores of Male Accounting Students Female Accounting Students

Ghiselli Measure	Male Accounting Students Mean	Female Accounting Students Mean	"t" Statistic
Supervisory ability	26.12	26.82†	—.39
Occupational achievement	32.89	33.98†	—.63
Intelligence	36.01	37.58†	—.90
Self-actualisation	10.24	10.12	+.62
Self-assurance	24.07	24.14†	—.40
Decisiveness	18.48	18.22	+.14
*Need for security	14.32	14.22†	+.53
*Working class affinity	14.52	14.30†	+.12
Initiative	28.51	27.46	+.56
*Need for high financial reward	6.89	6.68†	+.96
Need for power	11.10	11.48†	—.21
Maturity	28.18	28.10	+.42

†Higher female mean
*Negatively correlated with managerial talent

Studies at the University of Waikato completed the Self-Description Inventory. Of the sample 50 were female and 148 were male. An accounting student was defined as a student undertaking a course of study that would meet the educational requirements of the New Zealand Society of Accountants.

The mean scores for each managerial trait are shown in Table 3.

All the managerial traits have been considered except for masculinity-femininity. Interestingly, according to Ghiselli's research, the trait masculinity-femininity played no part in determining managerial talent. The trait failed to:

(a) distinguish between managers and line supervisors, as well as failing to distinguish between line supervisors and line workers;

(b) distinguish successful managers from less successful managers.

Female accounting students scored most favorably in eight of the twelve traits considered. As indicated in Table 3, three of the Ghiselli traits are negatively correlated with managerial talent, thus low scores on these traits indicate greater managerial talent. It should be noted that females scored higher on supervisory ability, occupational achievement and intelligence. These are the three traits which are considered to be most important in relation to managerial talent.

The results were tested for statistical significance using the t-test but none of the differences were significant. The results are shown in Table 3.

The conclusion from these results is that there is very little difference between the managerial abilities of male and female accounting students. This supports Ghiselli's belief that "the trait of masculinity-femininity plays no part whatsoever in managerial talent." It appears that the results of this study confirm the findings of previous research that suggest there is no significant difference between female and male students on personality and related factors.

Attitudes Toward The Accounting Profession

Some research has already explored the attitudes of male and female accounting students to the accounting profession. For example, Stolle [1976] surveyed and compared the attitudes of accounting students to public and industrial accountants.

The students who completed the Self-Description Inventory also indicated on a five-point Likert-type scale, their level of agreement to six statements concerning the accounting profession. The mean scores are shown in Table 4 separated into male and female accounting students.

Female accounting students scored slightly higher than male accounting students on the statement "Accounting attracts people with a high degree of initiative," whereas females scored lower than males on comparable Ghiselli trait. The difference is merely one of perception.

The differences in mean scores between males and females were not significant except for the statement "Accounting offers a satisfying career" (see Table 4). Female accounting students think that accounting offers a satisfying career, whereas male accounting students feel that such a career is less satisfying. A possible reason for this is that in New Zealand there has been recently a large increase in the number of women studying accounting. This, coupled with the fact men have traditionally dominated the accounting profession, may make such a career more challenging for women.

TABLE 4

Mean Scores For Male And Female Accounting Students

	Statement	Male Accounting Students Mean	Female Accounting Students Mean	"t" Statistic
1.	Accountants have a high professional status.	4.14	4.1	+ .27
2.	Accounting is a challenging career.	4.12	4.2	— .30
3.	Accounting attracts people who are well educated.	3.47	3.34	+ .67
4.	Accountants avoid taking risks.	2.86	2.84	+ .10
5.	Accounting attracts people with a high degree of initiative.	3.95	4.06	— .69
6.	Accounting offers a satisfying career.	3.63	3.96	—2.26*

*$P<0.05$

The higher the score the stronger the agreement with the statement.

Conclusion

The results of the research reported in this paper support previous findings which indicate that female and male students do not differ significantly on psychological characteristics. It is important that the employers of accountants recognize these factors when they are employing staff. The position of the accounting profession should be as appropriately described by Osman [1973], "A profession based on ethicality and business acumen should utilise all possible means to ensure that no person is denied opportunities on other grounds, e.g., socio-economic status, sex, race. . . ."

This is especially true when female accounting students hold quite positive attitudes to the profession. It is important that this enthusiasm is not diminished by anachronistic policies towards the employment of females. Ω

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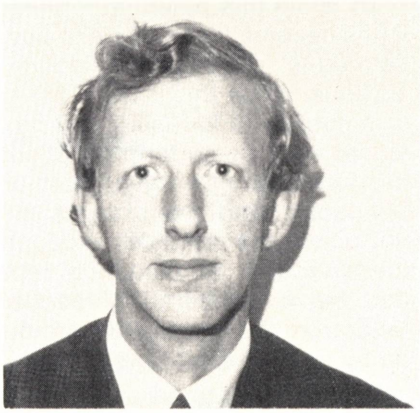
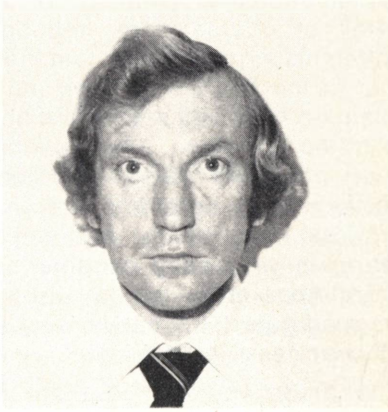
E. A. Cumpstone *is a junior lecturer in management studies at the University of Waikato, in Hamilton, New Zealand.*



Bruce R. Dixon *is a senior lecturer in management studies at the University of Waikato, in Hamilton, New Zealand.*



David B. Taylor *is a senior lecturer in management studies at the University of Waikato, in Hamilton New Zealand.*

Professional Liability Insurance

A Shopper's Guide

By Baruch Englard

Try to picture yourself in the following rather embarrassing situation: You are lying on a hammock in your backyard on a beautiful fall day (after the exclusion period for form 1040 has expired) enjoying the sunshine and thinking about how much money you made during the recent tax season, when suddenly the phone rings. You lazily pick it up and are shocked to hear the irate voice of one of your clients demanding an explanation as to why he just received a notice from the I.R.S. for the non-filing of his tax return. Your exclamation that "I mailed it on June 14th" of course does nothing to soften his anger (nor for that matter, that of the IRS either). You put the client on hold and search the house from top to bottom. After looking in every nook and cranny (and getting your knees scraped and dirty in the process), you finally find the tax return in your baby daughter's toy chest. Apparently, one day while you were off guard, the baby snatched it off your desk and hid it!!

What do you do? You are now faced with the possiblity of a lawsuit by the client for reimbursement of his tax penalties, the loss of his account, and to top it all off, a possible damage to your reputation.

Of course the above situation is a bit far-fetched, but there are many others that are not. Every practical accountant is aware of the tremendous upsurge in the number of lawsuits that have been brought in the last ten years. There have been suits brought by taxpayers, by banks who lent money based on incorrect financial statements, and by the general investing public that bought stocks and lost money by relying on false statements. Even the most careful accountant cannot always avoid mistakes. Nobody is perfect.

To avoid this potential nightmare, it has become fashionable to buy accountants' professional liability insurance. While this is not a panacea or a substitute for using due professional care in performing accounting services, it is a vital cushion to fall back on in times of crisis. It may not save the client's account or preserve the accountant's reputation, but it can certainly rescue the latter from the financial ruin brought on by a successful lawsuit.

Since the features of this kind of policy are numerous and complicated, this article will attempt to "lead the buyer by the hand" in advising as to what all the "fine print" is really saying. It is not enough to simply compare prices and take the lowest one; different policies have different attributes and comparing them is like comparing "apples to oranges." The buyer must also be able to analyze and understand what each policy has to offer. This article will attempt to do just that and will then conclude with some advice as how to avoid a lawsuit in the first place.

Before proceeding, a word of caution is in order. Policy terms frequently change from one year to the next. Prices may change as well as other features of the policy. Accordingly, the buyer should get the most recent sample of policies before making any decision.

Types Of Policies

Claims Basis vs. Occurrence Basis

There are two types of policies available today. The most common one is the "claims-basis" type. Under this policy, the insured is covered even for acts or omissions that took place prior to the inception of the policy, provided the claim is made during the policy period. The number of years covered before the inception of the policy varies from policy to policy. Usually, the larger the "retroactive coverage" the higher the premium.

Under this policy, the insured is only covered for retroactive acts if at the time he applied for coverage, there seemed to be reason to believe that any prior acts of his would eventually result in a claim.

Should the insured decide to terminate coverage, many policies provide an option (for an extra premium) of an extended reporting period of three to six years. This means the insured will be covered for claims arising during this period for acts or omissions that took place prior to or during the policy period.

The "occurrence type" policy only provides coverage for acts or omissions that took place during the policy period.

Sponsorship by State Societies

Some policies are sponsored by their respective home state CPA societies. This is definitely a favorable feature to look for, since the society "looks over the shoulder" of the insurance company and prevents the company from taking advantage of the insureds. For example, under the terms of the agreement between the INA Insurance Company and the New York State Society, no rate increases may be initiated unless proven to be needed based on a study by the Society of the company's claims and reserves.

Areas of Coverage

S.E.C. and ERISA

Not all companies provide coverage for preparation of statements for the Securities and Exchange Commission, or ERISA work. For accountants practicing in these areas, it is extremely important to examine the policy to make sure this vital protection is included.

Defense Costs

Most companies provide coverage for legal fees incurred in defending against a suit.

Predecessor Coverage

In cases where the insured is not the original owner of the firm, it is important for him/her to get coverage for the acts of all predecessors. Not all policies provide for this.

Misrepresentation

The plan sponsored by the AICPA provides coverage for misrepresentation except if made with an actual intent to deceive or defraud.

Libel

Some policies cover libel and slander charges brought against the accountant, unless the libel or slander was done in "bad faith." This coverage, however, is only for civil libel, not criminal libel.

Innocent Partner Coverage

As mentioned previously, there are some cases of misrepresentation and libel that are not covered. This could lead to problems for a partner in a CPA firm, who, while personally innocent, is still responsible for the acts of other partners. To prevent this from happening, it is advised that "innocent partner" coverage be obtained.

Coverage for Legal Services

Many CPA's who are also attorneys perform legal services for their accounting clients. The question arises as to whether the accounting insurance policy also provides protection for these services. Many policies will, indeed, provide coverage if these services are necessary or incidental to the services provided in the insured's capacity as a CPA.

Coverage for Employees

Most policies do not provide coverage for messengers, internal bookkeepers, phone operators and all other employees of the firm who are not engaged in the doing of accounting work for the client.

Interest Costs

If the insured decides to appeal a judgment made against him/her, some policies will pay for the interest that accrues between the date of the original judgment and the date of appeal.

Policy Limits, Deductibles and Exclusions

Policy Limits

Most companies provide liability coverage of up to five million dollars (the INA policy sponsored by the New York State Society goes up to ten million). Some companies also provide limits on coverage for defense costs while others, like INA and the AICPA plan, do not. However, even INA limits defense coverage on SEC cases to the amount of the limit of the liability coverage.

It is very difficult to suggest here the limits of coverage the CPA firms in general should acquire. This depends on such factors as the size of the firm, the number of clients it services, the economic condition of these clients, and the nature of the accounting services provided. Understandably, firms doing SEC work should obtain higher limits since their potential for liability is much greater. The exact amount of the coverage is best left to discussion with the insurance agent.

Deductibles

As is the case with most other insurance policies, the higher the deductible, the lower the cost of the policy. Most policies do not provide a deductible for defense costs, only for damages.

Exclusions

Many policies exclude coverage of certain areas where it is felt the risk is too high. This coverage can sometimes be obtained for a higher premium. If the insured does not practice in these areas, then, of course, it would be advisable to avoid such excessive and expensive coverage.

Numerous and complex features are built into liability policies. Discussion with an insurance agent will help define costs and risks.

Claim Settlement Policies

Consent of Insured

It is important that the insurance company not have the right to settle a claim without the consent of the insured. Many times a CPA firm will want to appeal a judgment in order to protect its reputation. The policy provided by the California Society of CPA's explicitly gives the CPA firm this right. However, if this results in higher costs, this policy requires the insured to pay them.

The policy should also contain a provision that the insured should not be required to contest a suit, or refuse any offer of settlement.

Acknowledgment of Claims

Under the "claims-made" type policy, a claim must be made during the policy period in order to receive coverage for that claim. To avoid any misunderstanding as to when a claim was actually made, the insurance company should be required to immediately acknowledge to the insured the reporting of a claim.

Selection of Attorney

The INA policy provides that the law firm selected to defend the claim must be on a list of approved law firms chosen by the New York State Society. This enables the insured to get the best and most experienced lawyers in this field.

Discounts

Some policies provide "good-guy" discounts — deductions in rates for firms that haven't had claims made against them over a specified number of years. Other policies provide discounts for firms with continuing professional education programs and peer reviews.

Conclusion

The selection of an appropriate professional liability insurance policy is one of the most important decisions to be made by a CPA firm. Great care should be taken in arriving at this decision. Total reliance, however, on the insurance policy while ignoring certain commonsense principles, is also to be avoided. The following are some of these principles:

A) Avoid suing for unpaid fees unless there is no other alternative. Such suits often bring on countersuits. It is usually better to arrange some kind of payment plan satisfactory to both parties.

B) Carefully follow G.A.A.S. and G.A.A.P. - many successful cases against CPA firms were based on the fact that these standards and principles were violated.

C) Obtain an engagement letter — this serves to prevent any misunderstandings on the client's part as to the nature of the service expected.

D) Avoid clients that are in trouble — many companies having financial difficulties take out their frustrations on their accountants.

E) Don't let your baby son or daughter roam around in your office unguarded.

Adherence to these principles will not guarantee freedom from lawsuits, but it certainly will go a long way toward preventing them. In case a lawsuit does arise, an accountants' professional liability insurance policy will protect and cushion the beleaguered practitioner.Ω

Baruch Englard, *CPA, is assistant professor of accounting at Brooklyn College. He is a member of AICPA and has practiced public accounting in New York City.*

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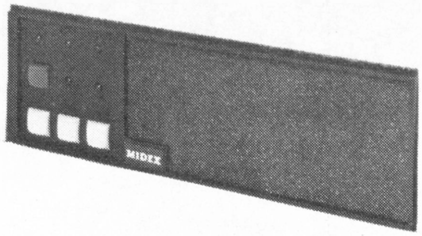

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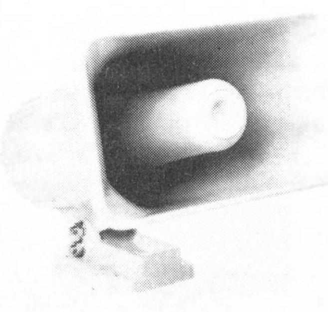

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You can set up the Midex in your own home in minutes. It looks like a stereo component. Just plug it into a wall socket, aim and adjust its protection pattern and connect two wires to the powerful alarm blast horn SP-30. If you wish, you can connect two alarm blast horns. If you connect 2 blast horns, we recommend one outside and one inside. A test light allows you to easily determine the area of coverage of the protection pattern. A thumb wheel lets you adjust it to your needs.

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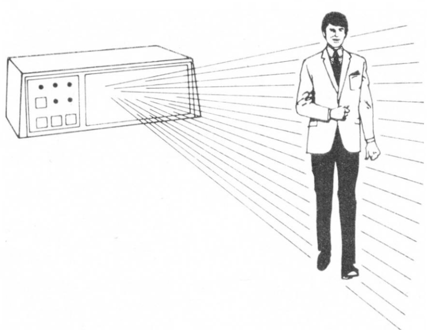

The adjustable pattern has a range up to 50 feet.

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The Sources and Consequences of Stress in a Public Accounting Firm

By Phillip T. Senatra

This study is an examination of stress as perceived by audit seniors in a Big Eight public accounting firm. The potential effects of stress are costly, not only to the individual in terms of emotional consequences, but also to the organization in terms of lower quality of performance and turnover. The purpose of this study is to examine potential consequences of stress experienced by audit seniors and to identify conditions which have the potential to contribute to stressful situations in CPA firms of all sizes.

Role Theory And The Audit Senior

The use of role theory and role concepts provides a useful analytical framework for examining stress. Measures of role conflict and role ambiguity can be successfully employed as operational measures of stress.

Role conflict is defined as the simultaneous occurrence of two (or more) sets of pressures such that compliance with one would make difficult or impossible compliance with the other. Role conflict can be thought of as existing when seniors perceive that their role senders hold contradictory or competing demands or expectations.

Role ambiguity is defined as the absence of adequate information which is required in order for seniors to accomplish their role in a satisfactory manner. Role ambiguity arises when the required information is nonexistent or, if existing, is inadequately communicated.

An examination of the audit seniors' role reveals that seniors exist in a position of interaction with others where there is a high potential for conflict and ambiguity. For example, married seniors are members of both the audit firm and their family. When the firm expects them to spend considerable time out of town, they may find such expectations in conflict with those associated with their roles as spouse and parent.

Seniors occupy a boundary position, that is, they must interact with people outside their own organization. Boundary position occupants generally experience a higher level of conflict and ambiguity than do those individuals whose activities are confined to their immediate organizational unit.

Within the audit firm, seniors must deal with the interests and expectations of both subordinates (junior position) and superiors (manager and partner positions). Incompatible role expectations are likely, and they may be accompanied by various pressures to comply from superior and subordinate role senders.

Since the senior position is an important one, the consequences and sources of role conflict and role ambiguity for audit seniors merit examination.

Potential Consequences and Sources of Role Conflict and Role Ambiguity

Three potential consequences of role conflict and ambiguity are increased job-related tension, decreased job satisfaction, and increased propensity to leave the firm. Numerous other consequences could also be considered. However, the three selected for study are representative and, logically, are potentially related to important problem areas concerning public accounting firms such as quality of audit performance and turnover.

This study will examine potential sources of stress which exist within the organizational climate of a CPA firm and the personal lives of audit seniors. Variables within the organizational climate with the potential to contribute to role conflict and ambiguity are classified into four categories as a basis for discussion: (1) organizational complexity; (2) coordination and communication; (3) authority, and; (4) professional freedom.

Inability of individuals to fully comprehend the organizational complexities of their firm may account for much of the stress existing within that organization. The structure of an organization should keep a member from being caught in the crossfire of incompatible orders or expectations. Also, certain organizational norms and responsibilities may not be compatible with a senior's perceptions of a desirable work environment.

Role conflict and ambiguity can therefore be seen as resulting from the degree to which certain organizational practices are perceived to exist in the organizational climate of a CPA firm. The specific measures used in this study are:

1. Violations in chain of command: the degree to which the chain of command is bypassed in the firm resulting in the potential for incompatible orders or expectations from more than one superior.
2. Conflict in directions: the degree to which objectives, directives, and guidelines of the firm conflict or are inconsistent.

3. Formalization of rules and procedures: the degree to which performance standards, standard practices, policies and position responsibilities are formalized explicitly.
4. Emphasis on subordinate personnel development: the degree to which seniors are expected to train and guide assistants and how well they are rewarded for it.
5. Superiors contribution to professional growth: the degree to which the senior receives formal and informal training, constructive performance appraisals and work reviews.
6. Job pressure: the degree to which there is excessive pressure and inadequate time and training to complete the various assignments.
7. Tolerance of error: the degree to which errors are dealt with in a supportive, learning manner rather than in a threatening, punitive, blame-oriented manner or climate.
8. Selection criteria for promotion based on ability and performance: the degree to which selection criteria are based on ability and performance rather than politics, personality, or educational credentials.

The second category of organizational climate is coordination and communication. Managerial philosophy about communication may contribute to stress. Individuals who have access to information may be insensitive to the information needs of others in the organization. In certain instances, individuals possessing required, or desired, information may restrain its dissemination for purposes of control. The practice of restricting the flow of information is not limited to superiors. It is one of the techniques which subordinates may employ to influence their superiors.

The degree to which problems of coordination and communication are perceived to exist by the senior in the organizational climate of the firm should be considered as potential sources of role conflict and ambiguity. The specific measures used in this study are:

1. Top management receptiveness: the degree to which superiors listen and respond to ideas and suggestions.
2. Adequacy of work coordination: the degree to which interrelated work activities are coordinated and how well other divisions of the firm are supportive and provide assistance.
3. Decision timeliness: the degree to which superiors respond to problems and make timely decisions.
4. Information suppression: the degree to which superiors and subordinates withhold relevant information.
5. Communication adequacy: the degree to which communications are accurate, timely, complete, and flow both up and down.

The third category of organizational climate is authority. To satisfactorily lead the audit team in the field, the senior must have adequate authority. Adequacy of authority is defined as the degree to which the senior has enough authority to make necessary decisions and handle work problems.

The final category of organizational climate is professional freedom. Professional freedom is defined as the degree of freedom individuals have to exercise their own professional judgement in performing their responsibilities. Role conflict and ambiguity could result if audit seniors perceive undue bureaucratic influence by their superiors with regard to the way the seniors are to carry out their responsibilities.

Research Methodology

A questionnaire was distributed to all audit seniors in eight offices of one Big Eight public accounting firm.[1] The office size ranged from approximately 30 to over 150 professional staff, with one-half of the seniors working in offices maintaining a professional staff of 60 or more. Questionnaires were returned by 88 of the total of 107 seniors for a response rate of 82 percent.

Seniors responded to questionnaire items using a one-to-five scale, with each value representing an appropriate verbal response for the variable being measured. The questionnaire contained 103 items which were combined into 29 variables for analysis. Internal consistency for each multi-item variable was evaluated by the Spearman Brown reliability method. Reliabilities were acceptable for the testing of relationships. Efforts to achieve validity for the variables included the use of a pilot study and reviews of the measurement instruments by a psychologist and members of the public accounting profession for the instrument's representativeness and applicability to the audit senior position. The instruments employed to measure each of the variables were as follows.

The measures of role conflict and role ambiguity were developed by Rizzo et al.[2] The measure of job-related tension was drawn from the anxiety-stress questionnaire used by House and Rizzo.[3] The job satisfaction scale was adapted from a questionnaire developed by Bullock.[4] Propensity to leave was measured by asking the respondents to indicate their intention to leave or stay with the firm.

Fourteen *a priori* variables were developed to provide specific measures of the organizational climate of a CPA firm. The variables are a modified version of a measurement of organizational practices developed by House and Rizzo.[5]

To measure professional freedom, certain professional duties and responsibilities of an audit senior, as described in the staff personnel policies of a public accounting firm, were listed. For each item, the respondents were asked to indicate to what extent they have the freedom to exercise their own professional judgment in carrying out the responsibility.

The study is concerned with evaluating the contributions of a set of variables and specific variables to role conflict and ambiguity. Emphasis is on the examination of particular relationships within a multivariate context. Therefore, stepwise multiple regression is used in a descriptive manner and not as an inferential tool. The standard F test is used to test for significance.

Results of the Study

It was expected that high levels of both role conflict and role ambiguity would be related to high job-related tension, low job satisfaction, and high propensity to leave the firm. Table 1 presents the measures of these relationships. The partial regression coefficients measure the relationships between role conflict

Table 1

Measures of the Relationships Between Role Conflict, Role Ambiguity, and Their Potential Consequences

Consequences	Role Conflict Partial Regression Coefficients	Role Ambiguity Partial Regression Coefficients
Job-related Tension	.458*	.116
Job Satisfaction	-.056	-.356*
Propensity to Leave	.139	.071

*Significant at the .01 level

Table 2

Stepwise Regression of Selected Variables and Role Conflict

Variables	Multiple Correlation	F Values
Violations in Chain of Command	.512	30.56*
Information Suppression	.645	22.31*
Superiors Contribution to Professional Growth	.683	7.93*
Formalization of Rules and Procedures	.692	2.05
Adequacy of Authority	.701	1.94
Decision Timeliness	.709	1.96
Top Management Receptiveness	.716	1.51
Communication Adequacy	.725	2.21
Conflict in Directions	.729	.99
Personal Factors	.730	.39
Criteria for Promotion Based on Ability and Performance	.732	.34
Tolerance of Error	.733	.28
Emphasis on Subordinate Personnel Development	.733	.06
Adequacy or Work Coordination	.734	.04
Professional Freedom	.734	.01

*Significant at the .01 level

Table 3

Stepwise Regression of Selected Variables and Role Ambiguity

Variables	Multiple Correlation	F Values
Communication Adequacy	.646	61.55*
Adequacy of Authority	.725	19.46*
Superiors Contribution to Professional Growth	.766	12.51*
Decision Timeliness	.785	6.33*
Violations in Chain of Command	.797	4.21
Professional Freedom	.805	2.92
Top Management Receptiveness	.812	2.56
Criteria for Promotion Based on Ability and Performance	.817	1.96
Emphasis on Subordinate Personnel Development	.820	1.18
Personal Factors	.826	1.12
Adequacy of Work Coordination	.828	.75
Conflict in Directions	.829	.58
Information Suppression	.829	.14
Job Pressure	.830	.09
Tolerance of Error	.830	.04
Formalization of Rules and Procedures	.830	.02

*Significant at the .01 level

and role ambiguity and each of the three potential consequences while controlling for effects of other consequences.

All relationships are in the expected directions. The relationships between role conflict and job-related tension and role ambiguity and job satisfaction are significant. The data provides support to the contention that the difficulties people have with their organizational roles increase as conflict and ambiguity increase. However, propensity to leave was not significantly related to the measures of stress. It is possible that audit seniors view conflict and ambiguity as an inherent part of the job so it does not result directly in a propensity to leave the firm.

Two stepwise multiple regression equations were developed with the potential sources of role conflict and ambiguity as the independent variables and role conflict and role ambiguity as the dependent variables. The order the variables entered the equations, the multiple correlations, and the F values are presented in Table 2 for role conflict and Table 3 for role ambiguity. The multiple correlations (R) indicate the strength of the relationship between the dependent variable and the independent variables that have entered the equation as of that step. If the multiple correlation is squared (R^2), the percent of variation in the dependent variable explained by the independent variables is disclosed. The F values shown as significant identify which individual variables explained a significant amount of the variation in the dependent variable.

The squared multiple correlation coefficients (R^2) for the final step of the multiple regression equations were .54 for role conflict and .69 for role ambiguity. Thus, the independent variables explained 54 and 69 percent, respectively, of the variation in role conflict and role ambiguity. The unexplained variance could be due to measurement error and also because the sources of role conflict and ambiguity arise from other role relationships such as relations with clients.

The significant F values indicate that three potential sources are significantly related to role conflict and four potential sources are significantly related to role ambiguity. All

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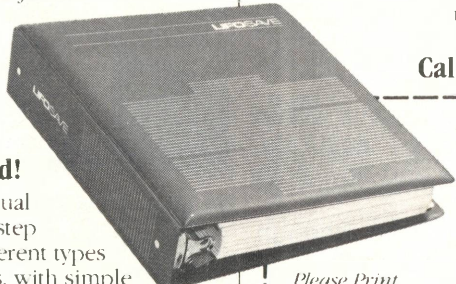

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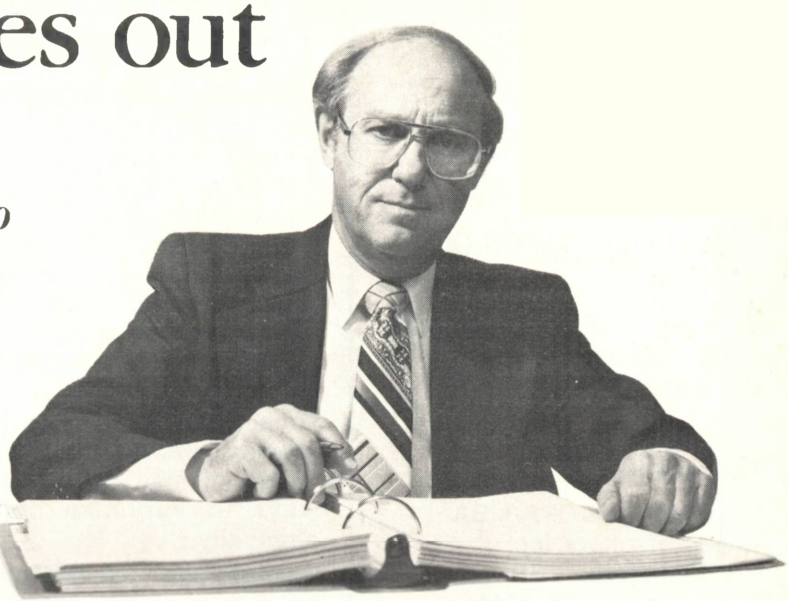

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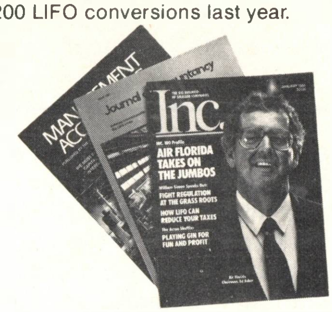

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of these sources come from the organizational climate of the firm. The combined effect of the personal factors was not significant, therefore, the firm should consider the organizational climate as an area to investigate for stress producing situations.

Implications for CPA Firms

Most of the specific variables significantly related to stress arose from various facets of the relationship between seniors and their superiors. Although some stress is unavoidable in the senior's role, the degree of stress experienced by seniors may be reduced if superiors could be made aware of which areas of the organizational climate are significantly related to conflict and ambiguity. An organizational goal should be to improve those areas over which the firm can exercise some control. Seniors' superiors need to be informed about problem areas because their views and the seniors views of the organizational climate are not the same. Other researchers have found that partners have a higher estimation than seniors of the quality of the firms procedures in many areas[6] and that there are differences in the perspectives and attitudinal orientations of the individuals occupying the different levels in the organizational structure of a CPA firm.[7]

The variable of "superiors contribution to professional growth" was significantly related to both role conflict and role ambiguity. This variable measured the seniors perceived adequacy of training, performance appraisals, and superiors' supportiveness. Apparently, one of the most important elements in the organizational climate is the attitude of the people in charge as perceived by their subordinates. Efforts to strengthen and improve interpersonal relationships, both formal and informal, between seniors and their superiors may be one of the best ways to minimize conflict and ambiguity.

Based upon the variables found to be significantly related to stress, some specific suggestions for reducing stress are:

1. Adequate opportunities should be provided for formal and informal training. Performance appraisals should be adequately communicated to seniors. Superiors should be willing to discuss work-related problems and be consistent in their expectations.
2. The chain of command should not be bypassed because this results in the potential for incompatible orders or expectations from more than one superior.
3. Superiors should respond promptly to a senior's problems and recommendations.
4. The senior's superiors should not withhold information or make important decisions about the job on which the senior is working without the senior's knowledge.
5. Overall communications within the firm should be accurate, timely, complete and flow both up and down.
6. Seniors should have enough authority to make all the decisions necessary to perform their job and handle work related problems.

The potential sources of stress represented by the variables which did not attain significance should not be discarded until this research is replicated with larger and more representative samples. For example, inadequacy of professional freedom was not found to be a significant source of stress. This result could be due to the fact that in the firm selected for study the professional freedom scores were consistently high. Such a climate may not exist in all firms.

NOTES

[1]The identity of the firm is confidential. Efforts to persuade other firms to participate in the study were unsuccessful in part because "some of the questions are too sensitive."

[2]John R. Rizzo, Robert J. House, and Sidney I. Lirtzman, "Role Conflict and Ambiguity in Complex Organizations," *Administrative Science Quarterly,* June 1970, pp. 150-163.

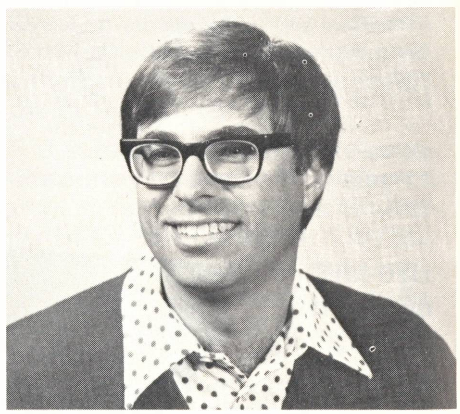
[3]Robert J. House and John R. Rizzo, "Role Conflict and Ambiguity as Critical Variables in a Model of Organizational Behavior," *Organizational Behavior and Human Performance,* June 1972, pp. 467-505.

[4]Robert P. Bullock, "Job Satisfaction Scale," Columbus, Ohio: Bureau of Business Research, The Ohio State University, 1965.

[5]Robert J. House and John R. Rizzo, "Toward the Measurement of Organizational Practices: Scale Development and Validation," *Journal of Applied Psychology,* October, 1972, pp. 338-396.

[6]Archie Faircloth and Michael Carrell, "Evaluating Personnel Procedures in CPA Firms," *Journal of Accountancy,* October 1978, pp. 38-48.

[7]James E. Sorensen, John Grant Rhode, and Edward E. Lawler, "The Generation Gap in Public Accounting," *Journal of Accountancy,* December 1973, pp. 42-50.



Phillip T. Senatra, CPA, Ph.D., *is assistant professor of accounting at Oregon State University in Corvallis. He previously served with the faculties of the University of Iowa, and of Iowa State University, and was senior accountant with Arthur Andersen & Co. He is a member of AICPA and AAA.*

The Woman CPA is pleased to introduce **Florence Haggis, CPA, MBA,** *as editor of the Theory & Practice column. She is audit manager with Touche Ross & Co. at their executive offices in New York and has had academic staff experience at Upsala College. Ms. Haggis is past national president of AWSCPA, past president and founder of North Jersey Chapter of ASWA, is a member of AICPA and Chairman of the Practice Review Committee of the New Jersey Society of Certified Public Accountants. She has been a contributor to the CPA Journal, wrote a chapter for the Touche Ross & Co.* Accountants Handbook *and revised the* Accountants SEC Practice Manual *(CCH).*

Theory & Practice

SEC Issues Guidelines for Management's Discussion and Analysis of Financial Condition and Results of Operations

Editor:
Florence Haggis, CPA, MBA
Touche Ross & Co.
New York, NY 10019

In 1980 the SEC adopted a sweeping revision of the mandatory business and financial disclosure requirements applicable to most U.S. publicly-held companies. This major revision, commonly known as the Integrated Disclosure System, standardized requirements for the form, content and timing of financial statements required by the 1933 and 1934 Securities Acts. One of its major changes was in the requirements of Regulation S-K, Item 11, for management's discussion and analysis of financial condition and results of operations. The new revised rules required information on financial condition as well as results of operations, and emphasized liquidity, capital resources, and the impact of inflation. In addition, the SEC encouraged but did not mandate forward-looking information. The overall rules were intentionally left general, with a minimum of specific requirements; companies were encouraged to disclose matters that were most significant in their particular circumstances.

A management's discussion and analysis of operations (MD&A) was first required in 1974. The rules stated then that annual reports to shareholders must include a "management's discussion and analysis of operations" for the latest two years, with detailed discussion of all material period-to-period changes in items of revenue and expense. The rules provided some very specific percentage tests with regard to these disclosure requirements, and as a result, MD&A reporting developed into a highly mechanistic and uninformative commentary on percentage variations.

It also became obvious that the focus of operations alone did not fulfill the SEC's original objective which was to provide needed information on an enterprises's planned future operations. Therefore, when the SEC revised its reporting requirements in 1980, it drew up a completely new set of MD&A rules.

Now, over one year later, SEC has issued its assessment of the Management's Discussion and Analysis sections of the 1980 annual reports (published in Accounting Series Release No. 299).

What was their evaluation of the 1980 MD&A sections? The SEC noted major improvements in the quality of MD&As although they "varied considerably in content, format and extent of coverage." More information has been presented on segments, significant events and trends, financial condition and changes in financial condition. The new discussions of economic, industry and specific factors, and uncertainties give a clearer picture of the company's financial position. Furthermore, many registrants disclosed forward-looking information about expenditures, operations and liquidity.

ASR 299 also provides examples of disclosures made by registrants under the new requirements which could be very helpful. In addition, the ASR provides guidance where

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further improvements could be made.

Following are some of the highlights of the SEC's observations:

Results of Operations

Although issuers have improved the form and content of their discussions of results of operations in terms of trends and segment disclosures, there is still a need to identify and discuss significant company events, including external as well as internal happenings (for example, the effect of the decontrol of U.S. oil prices, or the proposed Canadian oil production taxes and price restrictions).

Liquidity and Capitol Resources

Item 11 defines liquidity as "the ability of an enterprise to generate adequate amounts of cash to meet the enterprises's needs for cash." It has both short-term and long-term aspects involving internal as well as external sources and is often closely associated with an enterprises's capital resources. ASR 299 emphasizes that

- liquidity information should help users in evaluating a company's ability to generate sufficient cash to meet both current and projected cash needs;
- existing sources of liquidity include cash balances, assets readily convertible to cash, and current operating cash flows.
- MD&A should address liquidity in the broadest sense — that is, it should describe how operating cash flows may be impacted by internal and external sources, future commitments, trends in liquidity, significant events, uncertainties and changes in circumstances and explain that past results of operations are indicative or not indicative of the future;
- the discussion of liquidity ought to go beyond a simple review of current assets and liabilities;
- issuers should identify those balance sheet, income and cash flow items believed to be indicators of liquidity, and explain the reasons why those particular indicators are appropriate. Indicators of liquidity may be unused credit lines, debt-equity ratios, bond ratings, and restrictions under existing debt agreements;
- the liquidity discussion should compare assured available resources to expected short and long term requirements, discuss any identified deficiencies, and describe what action the issuer intends to take to meet those deficiencies.

As to remedies, ASR 299 encourages issuers to describe any anticipated cash resources, e.g., potential cash flows from expanded levels of operations, additional external financing, the sale of non-operating assets, etc. Issuers are also encouraged to identify and discuss factors relevant to an understanding of the company's future plans, objectives, and ability to complete those plans.

Evaluation of Disclosures

Short-term liquidity discussions generally have focused on working capital, "frequently supplemented only with information on funds flow from operations computed on a working capital basis." ASR 299 urges companies to make sure that the discussion fully addresses the subject of liquidity, since the ability to generate cash to meet cash needs generally depends on factors other than just working capital.

Using only working capital can significantly misrepresent a company's liquidity. It may hide both the uncertainty and timing of the conversation of current assets to cash or, conversely, it may fail to give the company credit for deliberately using cash management techniques that minimize current assets in relation to current liabilities. Furthermore, such a presentation of liquidity will probably fail to take into account the impact of unused available short-term credit; and it may only reflect LIFO inventory, thereby understating inventory values.

As an example of this kind of misrepresentation, ASR 299 points out that disclosures of a 3:1 ratio could lead to the assumption "that the company has ample ability to generate cash to meet its obligations in a timely manner. However, if the current assets consist of 10 percent cash, 50 percent receivables and 40 percent inventory, with approximately three-quarters of the inventory in raw or uncompleted form, it may be necessary to know turnover rates to evaluate the company's cash position accurately."

Another problem is that discussions of "working capital provided from operations" (as shown in most funds statements) can lead to "the erroneous concept that non-cash charges to income, such as depreciation, are sources of liquidity." To avoid this, MD&A should be expanded to include "cash flow from operations and other sources." This category should not be limited to net income adjusted for non-cash charges and credits, but should also consider changes in the various components of working capital — such as receivables, payables and inventory.

Computed this way, cash flow from operations is an especially helpful indicator, and the SEC encourages its display as a three-year trend. Note that "this measure is frequently very different from "funds flow from operations" computed on a working capital basis and the captions should not be used interchangeably."

In addition to cash flow from operations and related working capital conditions, the ASR suggests that assessments of liquidity should also include consideration of the following:

(i) Available unused sources of financing, including existing lines of credit, ease of access to markets, and convertibility of noncurrent assets to cash.
(ii) Trends in liquidity and known commitments.
(iii) Known or likely deficiencies and remedies.
(iv) Significant events and uncertainties, including flexibility to adapt to change.

The ASR gives examples of disclosures along these lines.

Inflation Disclosures

The SEC was concerned also about the adequacy of disclosures regarding the impact of inflation and changing prices on businesses. Although SFAS 33 applies only to certain companies, the SEC encouraged all issuers "to focus on translating the potentially confusing situation concerning inflation into a meaningful discussion of the effects of changing prices" on their business.

Illustrations of disclosures included the impact of inflation on:

(i) Sales
(ii) Monetary Assets/Liabilities
(iii) Inventory and Cost of Sales
(iv) Plant Assets and Depreciation, and
(v) Financial Intermediaries, such as, banks, savings and loan companies.

Conclusion

For those who are responsible for complying with the disclosure requirements of Regulation S-K, or for those of us who have SEC clients who need advice regarding Management's Discussion and Analysis, ASR 299 can be an invaluable aid, because it contains numerous illustrations and suggestions.

The ASR and its examples should be read carefully as useful reference material. However, keep in mind that the examples are only excerpts of more extensive disclosure and are not all-encompassing.

The SEC anticipates that MD&A disclosures will continue to improve with time, and the Commission intends to continue to review the MD&A disclosures and perhaps provide additional guidance in subsequent releases.

As a final note — the SEC, at the 1982 AICPA Current SEC Developments Conference in Washington, D.C., stated that MD&A will be the focal point of staff reviews of filings in the coming year. Ω

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With this issue The Woman CPA is pleased to introduce a new department to be called Compensation. **Mary R. Golden, CPA, D.B.A.** *will edit the Compensation column. Ms. Golden is associate professor of accounting, at Auburn University in Montgomery Alabama, and was previously associated with Harris, Kerr, Forster & Co., CPAs, in Memphis. She is a member of AICPA, AAA, AWSCPA and ASWA, and addressed the Joint Annual Meeting of the latter two societies in Memphis during the autumn of 1981.*

Compensation

Overview of Qualified Deferred Compensation Plans

Editor:
Mary Golden, CPA, D.B.A.
Auburn University
Montgomery, AL 36117

The purpose of this article is to give the reader an overview of qualified deferred compensation plans. Four general topics are discussed: plan design considerations, comparison of major types of plans, taxation of plan distributions and plan reporting requirements.

Plan Design

Good plan design depends on the purpose of the plan. Generally, this purpose is different for large publicly-held corporations and small closely-held ones. This article concentrates on plan considerations for the small corporation, where the purpose is to gain favorable tax treatment for key personnel while meeting the non-discrimination provisions of federal regulations. Good plan design, assuming maximization of benefits for a few key people, normally includes a) exclusion of participation of as many non-key individuals as possible, b) restriction of vesting provisions and c) integration with Social Security.

Participation

The Employee Retirement Income Security Act of 1974 (ERISA) allows participation standards which exclude employees who are not 25 years of age or who have worked for less than one year. A year of work is generally interpreted as working more than 1,000 hours in a 12-month period. It is also allowable to restrict participation to those employees who have at least three years of service, but they must be 100 percent vested upon participation. Unionized employees may be eliminated from the plan where "good-faith" bargaining for fringe benefits can be shown.

Another technique for participation restriction is referred to as the 70/80 rule. The rule allows exclusion of whole classes of employees as long as the limit is met. Basically this allows an employer to exclude up to 30 percent of employees as long as 80 percent of the remaining 70 percent participate in the plan.

Vesting

Vesting standards are another useful tool to reduce the cost of providing benefits to non-key employees. Even though employees are participants in the plan, until their benefits are vested (that is, nonforfeitable) there is no real cost to the employer. Three vesting formulas are outlined in ERISA: 1) cliff vesting, 2) 5/15 rule, and 3) rule of 45. An employer may adopt other schedules as long as they are no more restrictive than the schedules provided in the law.

Cliff vesting means that there is no vesting until the 10th year of service, at which point benefits become 100 percent vested. The 5/15 rule mandates 25 percent vesting after 5 years of service with annual increments until full vesting is reached at the end of 15 years of service. The rule of 45 bases vested amounts on the sum of the employees' age and years of service. The first stage of this schedule provides that the participants be 50 percent vested when the sum of their age and years of service equals 45, if they have at least 5 years of service. However, the IRS has the power to enforce stricter vesting rules if they feel discrimination has occured in practice.

Integration

Congress recognized the fact that an employer is already providing retirement benefits through payroll tax contributions. Further, these benefits are slanted towards the lower paid employees because of the contribution limit. Integration of a retirement plan with Social Security allows an employer to make up for this discrimination against higher paid employees.

Integration techniques differ with the type of plan adopted. For a plan that is classified as defined contribution (see discussion in subsequent section) the assumed Social Security contribution is 7 percent of compensation up to the annual limit. This percent takes into consideration death and survivor benefits built into the law. This assumption allows the employer to contribute an extra 7 percent of salaries over a certain level, called the integration level. The integration level can be set at any amount below the current Social Security maximum salary or a participant's covered compensation amount. Covered compensation is the weighted average of the Social Security limits during the working life of an employee. For example, an employee 30 years old would have a much higher covered compensation amount than a 50 year old employee due to the rising Social Security limits. As an illustration, assume there are three participants in a plan with salaries as follows:

Participant A —	$ 60,000
Participant B —	30,000
Participant C —	10,000
	$100,000

The allocation formula is:

1. 7% of all compensation over $15,000 (the integration level), plus
2. 5% of all compensation

The maximum contribution under this formula would be allocated as:

A's share, 7% of $45,000 plus 5% of $60,000	$6,150
B's share, 7% of $15,000 plus 5% of $30,000	2,550
C's share, 5% of $10,000	500
Total	$9,200

From the above example, it is clear that while A's salary was only 60 percent of total salaries A's share of the contribution was 67 percent ($6,150/$9,200).

For a defined benefit plan (also discussed in a later section), the integration level is expressed in terms of promised retirement benefits rather than promised contributions. The limit is 37 1/2 percent of compensation which is the average Social Security retirement benefit. This means that a defined benefit plan can promise up to 37 1/2 percent higher benefits to key personnel whose salary exceeds Social Security coverage.

All three of the above design tools enable an employer to slant retirement plan benefits to higher paid key employees without violating discrimination rules and thereby losing the favorable tax treatment afforded qualified plans. They key design element, however, that must be considered is the type of plan to be adopted.

Major Types of Qualified Plans

Generally, deferred compensation plans are classified as defined contribution or defined benefit. The following is a review of the key characteristics of these two types of plans and a discussion of multiple plans.

Defined Contribution

There are two basic types of defined contribution plans: Money purchase and profit sharing. Both types share certain common features, such as:

1. Funding of plans is relatively simple and easy to explain. An actuary is not required.
2. Younger employees generally receive higher benefits.
3. Individual participation accounts are maintained, which allows direction of investments by individual participants.
4. Annual addition to each participant's account is limited to the lesser of 25 percent of compensation or a set amount ($41,500 for 1981).

Of the two types of plans, profit sharing ones are most common because of their flexibility. An employer can contribute little or nothing in lean years and increase contributions in more profitable years. Contributions are limited to 15 percent of covered payroll with a 10 percent catch-up allowance. For example, an employer could contribute 5 percent of salary in one year and 25 percent the next. This stays within the 15 percent per year cumulative restriction and the 25 percent per year maximum.

Another distinctive feature of profit sharing plans is that forfeitures from non-vested employees whose services are terminated are reallocated to the remaining participants. These reallocated forfeitures are taken into consideration when determining if the 25 percent limitation is met.

Contributions to a money purchase plan are a fixed percentage of participant compensation. ERISA classifies these plans as pension plans that come under ERISA's minimum funding standards. The employer could be subjected to a 100 percent non-deductible excise tax if plan contributions are not made on a timely basis.

An advantage of money purchase plans is the increased deduction allowance. An employer can contribute and deduct up to 25 percent of covered compensation per year under this type of plan. Forfeitures from terminated employees reduce the employer's contribution rather than being reallocated as in profit sharing plans.

In addition to profit sharing and money purchase plans, the defined contribution family also includes less common plans, such as: Simplified Employee Plans (SEP's), Stock Bonus Plans, Employee Stock Ownership Plans (ESOP's), and TRASOP's (Tax Reduction Act Stock Ownership Plans).

Defined Benefit

Defined benefit plans are normally more complex than defined contribution plans. The calculation of the employer's contribution is based on assumptions about retirement salaries, interest rates, etc., rather than use of a fixed formula. ERISA requires that an actuary, enrolled under provisions in the Act, certify to the correctness of these calculations.

The principal advantage of defined benefit plans in closely-held companies is that they allow accumulation of large retirement benefits in a short period of time. For example, a 59 year old professional making in excess of $200,000 a year (some people do!) who wishes to retire at age 65 could only contribute $41,500 annually for the six years to a retirement fund in a defined contribution plan. This contribution would provide a *total* retirement benefit of approximately $300,000. Under a defined benefit plan, however, the annual contribution could be as large as necessary to guarantee an *annual* retirement benefit in excess of $100,000.

The maximum limitation on promised annual retirement benefits is the lesser of 100 percent of average pay for the highest three years or a fixed amount (set at $124,500 for 1981). This benefit is reduced for less-than-10-year service periods, integration with Social Security, early retirement and other beneficial provisions. If this promised benefit limitation is adhered to, there is no limit on the amount deductible on the employer's tax return for any one year.

In order to prevent sole shareholders from setting up a defined benefit plan and then terminating the plan after their retirement, certain restrictions have been included. One burdensome restriction is being subject to Pension Benefit Guaranty Corporation (PBGC) liability. ERISA established this non-profit corporation to insure pension benefits. When a defined benefit plan is terminated, the PBGC may assess a lien on up to 30% of corporate assets in order to ensure availability of promised benefits. In addition, annual insurance premiums must be paid to this organization.

Multiple Plans

To maximize benefits in deferred compensation plans, it is sometimes useful to combine plans. ERISA provides for two limitations when multiple plans exist. These limitations are over and above those associated with each individual type of plan.

If an employer provides a profit sharing plan and any other type of pension plan, the annual contribution for each participant from all plans combined cannot exceed 25 percent of compensation. If the multiple plans do not include a profit sharing plan, then the 1.4 rule is applicable. This rule states that the contribution to, or benefits from, all plans combined cannot exceed 140 percent of the maximum contribution or benefits allowed. For example, assume an employer establishes a 15% money purchase plan and an 80 percent defined benefit plan for the employees. The 1.4 rule is applied as follows:

Money purchase plan—

$$\frac{\text{Employer's contribution}}{\text{Maximum allowable contribution}} \qquad \frac{15\%}{25\%} = 60\%$$

Defined benefit plan—

$$\frac{\text{Employer paid benefit}}{\text{Maximum allowable benefit}} \qquad \frac{80\%}{100\%} = 80\%$$

Total 140%

This example falls within the 1.4 (140 percent) rule and is an example of a permitted combination.

The above considerations all were concerned with initial plan design. There are prototype plans available for adoption. However, before using these master plans, be sure they meet all needs.

Taxation of Plan Distributions

The taxation of distributions from a qualified plan depends on whether the benefits are received in a lump sum payout or as periodic payments. Periodic payments are taxed as ordinary income in the period received, assuming all benefits come from employer contributions or tax deferred employee contributions. Lump sum payouts may be taxed in several ways.

Lump Sum Distributions

A payout qualifies as a lump sum distribution if it meets all of the following requirements:

1. Distribution must be within one taxable year (not necessarily the year the following events occur).
2. Amount distributed must be the entire balance due the participant from all of the employer's qualified pension plans, stock bonus plans, *or* profit sharing plans.
3. Distribution must become payable (a) as a result of the participant's death, (b) after the participant reaches age 59 1/2, *or* (c) as a result of the employee's separation from service.

If the distribution qualifies as a lump sum distribution, there are three favorable tax treatments. They are capital gains treatment, 10-year averaging, and tax deferral due to rollover. Ordinary income treatment is required when distributions do not qualify for one of these three methods.

Capital Gains — Any part of a lump sum distribution allocable to pre-1974 service is afforded capital gains treatment. The amount so allocated is based on the ratio of time spent in the plan prior to 1974 compared to total time as a plan participant. The actual amount allocated to the participant's account before 1974 is not important. An employee has the option of treating all of the distribution as ordinary income, if the 10-year averaging rule described below produces a lower tax liability.

Ten-Year Averaging — The 10-year averaging method basically taxes the distribution as if it were received over a ten year period. There is also a "minimum distribution allowance" which reduces the taxable amount for distributions less than $70,000. The "single" taxpayer rate is used to calculate the tax on 1/10 of the distribution. This calculation is made without reference to any other income the participant may have for the year of distribution, thus mitigating the effect of progressive tax rates. The resulting tax is then multiplied by ten to arrive at the tax liability.

There are several general restrictions applicable to use of the 10-year averaging rule. First, this method can only be used once after a person reaches age 59 1/2. Second, an employee must have been a plan participant for five or more taxable years before the taxable year of the distribution. Third, if the employee has used this method within the last six years, the new distribution is aggregated with the prior distribution. Such treatment forces taxation at the higher tax rates and disallows use of the "minimum distribution allowance" more than once within a six-year period. This is referred to as the "look back" rule.

Tax Deferral due to Rollover — Within 60 days of receipt of a lump sum distribution from a qualified plan, a participant can roll the distribution over into an Individual Retirement Account (IRA) or other qualified plan. This rollover defers any taxation until the amount is withdrawn from the IRA or other qualified plan. If any amount of a lump sum distribution is rolled over in this manner, the capital gains treatment and the 10-year averaging method described above are no longer available for any part of the distribution either at that time, or later when the benefits are withdrawn. Distributions attributable to employee contributions cannot be rolled over. Rollover treatment is permissible when a plan termination caused a distribution, even though the employee has not terminated employment or reached age 59 1/2.

Plan Reporting Requirements

Various forms must be completed when the plan is adopted or terminated. However, the following discussion is limited to reporting requirements for an ongoing deferred compensation arrangement.

Federal Reporting

The basic requirement for federal reporting is the filing of the annual report, series 5500. The report form used depends on the type of organization and the size of the plan. Corporate plans with more than 100

THE EDUCATIONAL FOUNDATION OF AWSCPA—ASWA

Professional education of women accountants is an important goal of both American Woman's Society of Certified Public Accountants (AWSCPA) and American Society of Women Accounts (ASWA). Thousands of dollars have been contributed since 1966 to the Educational Foundation by members of the two societies for use in funding projects that include the printing of career literature, award of scholarships, statistical surveys of members and funding of complimentary subscriptions to **The Woman CPA.** The success of proposed educational activities by AWSCPA and ASWA is heavily dependent on funds channeled from the membership into the Foundation. Since the Foundation is without endowment or corpus large grants are solicited from members, and matching gifts from employers, to subsidize regional and area accounting seminars, graduate fellowships, periodic distribution of **The Woman CPA** to accounting departments of accredited colleges and universities, and new career literature.

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P.O. Box 389
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participants generally are required to file form 5500. In most cases, an auditor's opinion must accompany the form. Smaller plans file either 5500C or 5500R, neither of which requires an audit. Defined benefit plans must include Schedule B signed by an enrolled actuary attesting to the contribution amount. Additionally, Schedule A must be completed if insurance policies provide some benefits of the plan.

If any participants have left during the year with deferred, vested benefits, form SSA must be attached to the applicable 5500. This form alerts the Social Security Administration that certain benefits are due a particular employee at retirement, and the SSA will so notify the employee at such date. Most defined benefit plans must also file annual returns with the PBGC.

Participant Reporting

Under ERISA, participants have the right to review all plan documents and financial statements upon request. They also have the right to receive each year a summary of the annual report referred to above. Additionally, once a year they can request a statement of their accrued benefits to date. A statement of accrued benefits must also be provided upon retirement or other severance from the plan. Upon adoption of the plan and every five or ten year thereafter, a summary plan description written in terms understandable to all participants must be provided. The five year interval is required if any plan amendments have been made during the preceding five years. If a participant receives a distribution from the plan during any period, they must be provided with a W-2P or 1099R, depending on the nature of the distribution.

Concluding Remarks

As mentioned at the outset, this article was intended as an overview. The purpose was to provide the reader with a general knowledge of certain types of deferred compensation plans, the taxation of benefits from these plans, and reporting requirements attendant to these plans. Future articles will detail many of the points addressed here and review additional topics in the deferred compensation arena. Ω

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CMA Profile and Commentary

A New Elite Corps

By Guy L. Cochran, O. Ronald Gray, and Kenneth J. Morey

Since 1972, when the Certificate in Management Accounting (CMA) examination program was established, over two thousand CMA certificates have been issued. This article relates the results of a demographic study of this select group of management accountants, in the form of a profile and commentary on CMA holders. Such a profile is of more than passing interest because it provides insight into the characteristics of individuals who have successfully participated in the CMA program. Moreover, such a CMA profile may stimulate interest and participation in the program by other management accountants.

Survey

The questionnaire used in the survey asked CMAs to provide information about their membership involvement in professional organizations, professional certifications held, academic degrees held, present employment, number of years experience in various areas of employment, present management level, age, and sex. Questionnaires were mailed to 629 CMAs selected on a random basis from a listing of all CMAs provided by the Institute of Management Accounting (IMA). Three hundred and twenty-four usable responses were received for a response rate of 52%. This number of responses resulted in a ± 5% precision level at a 95% level of confidence. That is, there is a 95% probability that survey response percentages are within ± 5% of percentages responses obtainable from a complete census of CMAs.

Professional Affiliations

As Exhibit 1 shows, a majority of CMAs are active in one or more professional organizations. As one might expect, the National Association of Accountants (NAA) is the professional organization with the largest number of CMAs (approximately 69 percent). Moreover, CMAs tend to be actively involved NAA members. Some 19 percent of CMAs serve as officers or directors of NAA chapters. Approximately 34 percent are members of the American Institute of Certified Public Accountants (AICPA), the second most frequent professional organization membership held by CMAs. Other organizations such as the Financial Executive Institute (FEI) and the Institute of Internal Auditors (IIA) have relatively few CMAs as members. Interestingly enough, some 26 percent of CMAs are active in one or more other professional organizations.

Exhibit 2

Professional Certifications

	Percent of CMAs Holding Other Professional Credentials
CPA	41
CIA	4
CDP	4
Other	4

It is interesting, as indicated in Exhibit 2, to note that a substantial percentage of CMAs have one or more other professional credentials as well. As one might expect, given the large number of CMAs belonging to the AICPA, the most common other ceritifcation held is the CPA certificate. Approximately 41 percent of CMAs are CPAs who have participated in the CMA certification program. Of course, many CMAs who hold CPA certificates are no longer active in public accounting. Most CPA/CMAs are employed in private industry. However, a number of CPAs in public accounting practice who are heavily involved in management advisory services or consulting activities apparently have felt the need to objectively demonstrate their competency and proficiency in management accounting and have used the CMA as a means of doing so. Approximately 12 percent of CMAs are Certified Internal Auditors, Certified Data Processors, or hold one or more lesser known certifications. One individual, an academic, was found to have four professional certifications: CPA, CMA, CIA, and CDP. This is a curious exaggeration of the tendency exhibited by many CMAs to arm themselves with professional certificates.

In summary, many holders of

Exhibit 1

CMA Participation in Professional Organizations

Professional Organization	Percent of CMAs who are Members	Percent of CMAs Officer/Director
NAA	69	19
AICPA	34	1
FEI	4	0.6
IIA	4	1.5
Other	26	1

CMAs have demonstrated a proclivity to sit for professional certification examinations. One conclusion reasonably drawn and defended is that CMAs tend to be individuals who are very achievement oriented and are likely to seize any opportunity to demonstrate their proficiency and competency. A less kindly interpretation might be that many CMAs use test taking to reassure themselves about their own competence.

Employment

As indicated in Exhibit 3, a significant majority of CMAs (65 percent) are employed in industry. Of this group, (54 percent) describe themselves as being middle management and an additional 20 percent as first level management. Only 21 percent of CMAs are self-proclaimed top management types. This distribution reflects the relative youth of CMA holders (see Exhibit 8), and leads one to the conclusion that the CMA program is very likely to be the beneficiary of reflected glory in the future. That is, the CMA designation is likely to assume new status and gain increased prestige as present CMA holders mature and advance in the corporate hierarchy.

There is a virtual tie between education (14 percent) and public accounting (13 percent) for second place in terms of numbers of CMAs employed as shown in Exhibit 3. The CMA program has received considerable support, acceptance, and promotion from the academic community. Accounting periodicals frequently carry university teaching position announcements which list as a minimum criteria for employment consideration either CPA or CMA. Many academics, particularly those who teach cost/managerial type accounting courses, have become CMAs. In addition, a number of academics are residents of states, such as Alabama, in which the public accountancy law effectively precludes non-public practitioners from sitting for the CPA Examination. This restriction accompanied by a requirement for a minimum percentage of professional certificate holders in the new accreditation standards for accounting programs has resulted in many accounting faculty being actively encouraged by their department chairperson to sit for the CMA.

CMAs who are employed in public accounting are generally active or interested in management advisory services. From the perspective of a public accounting practitioner, the CMA is a luxury, nice to have but definitely a non-essential. Some CPAs tend to view the CMA as something that might be done to get some mileage out of preparation for the CPA examination. Others, particularly CPAs involved in management advisory services, view the CMA as a means of validating their expertise in the management accounting area thereby increasing their marketability. The distribution of CMAs among recognized public accounting personnel levels suggests that those individuals at the senior levels are more likely to be interested in the CMA. (See Exhibit 3) Generally, staff accountants are concerned with passing the CPA examination. After the pressing urgency of the CPA examination has passed, a staff accountant is more likely to think about the CMA.

Exhibit 3

A. Employment of CMAs

	Percent of CMAs
Industry	65
Public Accounting	13
Government	3
Education	14
Other	5

B. CMAs Employed In Industry

Classified by Management Level	
Top	21
Middle	54
First Level	20
Other	5

C. CMAs Employed In Public

Accounting Classified By Level	
Partner	38
Manager	26
Supervisor	12
Senior	17
Junior	7

D. CMAs Employed In Education

Classified By Academic Rank	
Full Professor	20
Associate Professor	41
Assistant Professor	28
Instructor	10
Other	1

Exhibit 4
Years Experience

Industrial

Years	Percent
0	20
1-5	28
6-10	25
11-15	17
Over 15	10

As seen in Exhibit 4, of those CMAs who have industrial experience, over two-thirds have 10 or less years of such experience. It is interesting to note that 19 percent of CMAs have no industrial experience at all. This is a paradox for a certification program with an avowed management accounting thrust. Many CMA holders without industrial experience are academics and some are involved in management advisory activities in public accounting firms.

Exhibit 5
Years Experience

Public Accounting

Years	Percent
0	63
1-5	27
6-10	7
11-15	2
Over 15	1

Some 37 percent of CMAs have had some public accounting experience. Among this significant minority relatively few, as seen in Exhibit 5, have more than five years experience. The most common length of experience in public accounting is two years. This is a natural consequence of the minimum experience requirement which many states have for obtaining the CPA certificate. Very few CMAs with public accounting have more than eight years such experience.

Exhibit 6
Years Experience

Education

Years	Percent
0	78
1-5	8
6-10	9
11-15	4
Over 15	1

A significant number of CMAs (22 percent) have had some experience teaching. Given the substantial number of academics who are CMA holders and the overall educational background of CMAs, this is not a particularly surprising statistic. Consistent with the relative youth of the group few CMAs have more than ten years teaching experience.

Personal Characteristics

Exhibit 7
Academic Degrees

	Percent of CMAs Holding
Bachelor	94
Master	67
Law	1
Doctorate	0

As a group, it seems evident that CMAs are well prepared in terms of formal schooling. The academic credentials of CMAs are truly impressive. Results presented in Exhibit 7 show that only six percent of CMAs do not have at least an undergraduate degree and a majority have a master's degree or higher. There are few other professional accounting groups that can boast such educational accomplishments.

In examining the academic accomplishments, one must remember that there is a degree of double counting to be adjusted out. Specifically the questionnaire asked CMAs to indicate all degrees held. Hence, a reasonable assumption would be that under normal circumstances all CMAs holding a doctorate would also hold a master's degree and an undergraduate degree as well.

The educational attainments of CMAs are consistent with what one might expect. One cannot avoid noting the achievement orientation of CMAs. There is a consistent pattern of assertive involvement in all areas, i.e., professional organization, certifications held, and educational accomplishments. It seems that CMAs as a group are consciously and purposefully grooming themselves. One might reasonably characterize CMAs as strivers and tryers; accountants who have an unfulfilled desire for recognition and status. It seems evident that these accountants are the "comers," i.e., leaders, innovators, competitors who will ultimately excel; a group to watch in the next twenty years as they fulfill their aspirations.

Exhibit 8
Age of CMAs

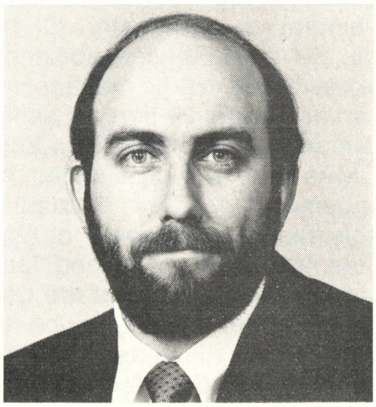
Years	Percent of CMAs
25-34	46
35-44	43
45-54	8
55-64	3

Less than 1 percent of CMAs are under age 25 or over age 64. Consequently, these were not set out as a separate category in Exhibit 8. Most CMAs are from the leading edge of the post World War II baby boom. The median age, i.e., an equal number older and younger, for CMAs is 35.5 years. Hence, CMAs as a group are yet to arrive at their most productive age. One can speculate that many CMAs have used professional certification as a means of differentiating themselves from their baby boom cohorts who vie with them for jobs. Presumably, they view the CMA and other professional certifications as a competitive advantage that will assure that they stand out from their cohorts.

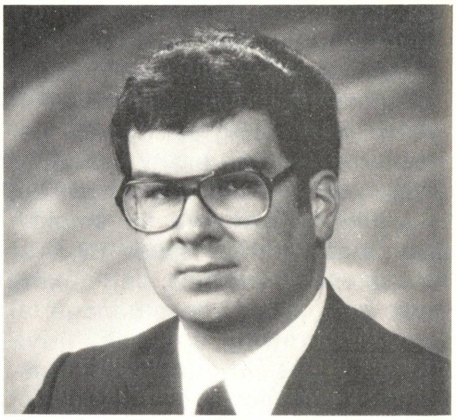
A surprising result of the survey was that only six percent of CMAs are female. The CMA is clearly a male dominated program. To some degree this is a natural consequence of traditional job patterns which results in male dominance. Times, however, are changing; given the increasing numbers of women graduating from accounting programs and entering the profession this should and probably will change in years to come. Still the CMA program was established in 1972 well after the feminist movement brought heightened consciousness of sex discrimination and encouraged females to break down barriers to advancements. Why then are there so few female CMAs? Why does the CMA have so little evident appeal to women? This is a question which bears some investigation.

In Conclusion

CMAs have some very impressive credentials. Their credentials are all the more impressive when considered in light of their relative youth. The evidence suggests that CMAs are a very select group of accountants who have outstanding promise. There is good reason to believe. based on their past accomplishments, that this promise will be realized. The reputation and standing of any program is a reflection of the achievements and deeds of individuals who have participated in the program and are thus identified with it. In this respect, the CMA program is indeed fortunate to have attracted participants who are outstanding performers. This virtually assures the CMA program of increasing prominence and recognition in the years ahead. Ω



O. Ronald Gray, CPA, Ph.D., *is assistant professor of accounting at the University of Alabama at Birmingham. He holds the CMA and is a member of South Birmingham Chapter of the National Association of Accountants.*



Kenneth J. Morey, MBA, CMA, *is assistant staff manager — corporate accounting, for South Central Bell Telephone Co., and is a member of the South Birmingham Chapter of NAA.*

Guy L. Cochran, CMA, *is staff manager — regulatory accounting, for South Central Bell Telephone Co. and is a member of the South Birmingham Chapter of NAA.*

With this issue The Woman CPA is pleased to introduce **Jewell Lewis Shane, CPA,** *as editor of the Reviews column. Ms. Shane is with the audit staff of Price Waterhouse & Co. She is a member of AWSCPA, the Cincinnati Chapter of ASWA, and the Ohio Society of CPAs.*

Reviews

Reading Notes & Quotes

Editor:
Jewell Lewis Shane, CPA
Price Waterhouse & Co.
Cincinnati, OH 45202

MEN AND WOMEN OF THE CORPORATION, by Rosabeth Moss Kanter, Basic Books, Inc., Publishers, New York, 1977, Paperback $4.95

Who does the most power go to in an organization? Why do some people rise in the corporation while others, often more talented, end up in dead-end positions? Why is the "failure rate" of women and minorities much higher than those of white males? What are the characteristics of the powerless people? What is "tokenism?" Why do tokens face special situations and perform their jobs under different public and symbolic conditions?

Professor Kanter, Yale University, provides the sociological explanation of organization behavior in a complex and engrossing book that won the C. Wright Mills Award in 1977. The corporate structure of opportunity, power and relative number (proportions and social composition) are the underlying determinants of organization behavior. This theory is supported by several research and action projects conducted by Kanter in major corporations.

Opportunity

Opportunity is mobility and plenty of it! Opportunity breeds opportunity. Superstars don't get as many fouls called against them. People who get all A's sometimes get one when they don't deserve it. Mobile people rarely stay in one position long enough to master it fully and they are not rewarded by the system if they do so. Mobile people are pulled through the back door, not through the channel.

Kanter is very convincing in her suggestion that opportunity does indeed shape behavior. The characteristics attributable to "women as a group" are the normal human responses to blocked opportunities and are exhibited equally by men in terminal jobs.

High mobility people tend to foster rivalry, instability in the composition of work groups, comparisons upward in the hierarchy rather than toward members of their own peer group, and concern with intrinsic aspects of the job. They show greater concern with the task, suppress irrelevant communications and are less critical of upper groups.

On the contrary, low mobility tends to foster camaraderie, stably composed groups and concerns with extrinsic rewards — both social and monetary. Relationships and interpersonal involvements are the highest reward in work and appropriately a substitute for lack of high mobility. The office storyteller is usually someone who is "stuck" and uses gossip to gain prestige because there are few alternatives.

Playing it safe is a strategy of dead-enders. They are reluctant to do anything innovative and resist any changes proposed by others. They criticize those who have made it and resent bitterly any attention given to the upward mobility of women and minorities.

High-opportunity managers actively favor upgrading women and minorities, sometimes because of value systems differing from low-opportunity individuals, sometimes because they see a personal advantage to themselves by showing that they can manage a challenging situation, and sometimes because they are not personally threatened.

Power

Power is the ability to get things done, to mobilize resources, thus it means having access to whatever is needed for the doing. Somewhere behind the formal organization chart is another shadow structure in which dramas of power are played out.

People who seem to have access to the inner circles that make decisions affecting the fate of individuals in organizations are more effective leaders, and better liked in the process. Subordinates behave in more cooperative and less critical ways, inhibit their negativity and aggressiveness, thereby reducing the need for the leader to exercise strong controls. This favorable situation enables the person to behave like a "good leader." On the other hand, nonmobile managers behave in rigid, authoritarian ways and use more coercive than persuasive power to get the job done.

Power wipes out sex. Followers who want to attach themselves to power do not even notice sex. However, there is a widespread belief that women are individual "movers" and cannot take anyone else with them even if they move up in the corporation. In these cases, no political advantage is seen in making alliances with women. Interestingly, men who are powerless behave in the same ways as the stereotyped female manager — bossy, controlling, critical.

Sponsorship by superiors is critical in producing a "good" leader. Sponsors provide an important signal to other people, a form of "reflected power." This indicates to others that the person in question has the backing of an influential person, that the sponsor's resources are somewhere behind that individual.

"People who have authority without system power are powerless. People held accountable for the results produced by others, whose formal role gives them the right to command, but who like sponsorship, mobility prospects, access to resources and informal political influence are rendered as powerless in an organization." Thus, they are ineffective leaders.

Nothing diminishes a leader's power more than subordinates' knowledge that they can go over his/her head. Subordinates are automatically obedient toward the powerful but direct more intense aggression to the powerless. It is as though followers extend "credit" in the present for imagined future payoffs.

Numbers

Sheer proportion of women, men, blacks and ethnic minorities in any given social situation determines who is "different." As proportions begin to shift, so do social experiences, so that numerical distributions underlay the behavior and treatment of the relative few in an organization.

The very nature of the business environment produces conditions of uncertainty. The greater the uncertainty, the greater the pressures are for those who have to trust each other to form a homogeneous group. Additionally, the lack of structure in top jobs make it important for decision-makers to work closely in shared understanding and a degree of mutual trust. Closed inner circles in which trust is assumed are achieved by two kinds of homogeneity: similarity of social background and characteristics or similarity of organizational experience.

Dominants have slowly accepted tokens into their midst but at the same time informally isolated them. Kanter's research showed that tokens tend to be excluded in the networks by which informal socialization occurs and politics behind the formal system are exposed.

Dominants also pressure tokens to turn against members of their own category. For example, women acting to exclude other women from the upper ranks are taking over the "gatekeeping" functions for dominants, letting them appear free of prejudice. The "Queen Bee Syndrome" thus is explained as having structural (numerical) origins rather than sexual origins.

The stresses and costs encountered in token situations are all too real. "Even successful women who reported little or no discrimination said that they felt they had to work twice as hard and expend more energy than the average man to succeed. The token does not have to work hard to have her presence noticed, but she does have to work hard to have her achievements noticed."

The token position contains a number of dilemmas and contradictions. "As long as numbers are low, disruptions of interaction around tokens (and their personal problems) are seen by the organization as a high deflection from its central purposes, a drain of energy, leading to the conclusion that it is not worth having people like the tokens around. Yet the disruptions are primarily a function of the numbers being low and could be remedied by proportional increases."

Understanding

Kanter's structural model of organization behavior not only contributes to theory, but provides the background and basis for practice. Business leaders can now enhance the performance and productivity of the workers women and minorities supervise. At the same time, they can make "good" leaders out of women and minorities by providing favorable positions with respect to opportunity and power.

This book should be required reading for all men and women in business if they are to be prepared to deal with future of American society as a whole. "What men think about women's potential as workers and leaders may be honestly based on the women they know best: their wives and secretaries. That these women may be limited in their behavior by the constraints of their own roles is an issue that never crosses the minds of men who deal with them. Making changes depends on understanding — seeing the underlying causes of behavior: how organizations systematically make some people 'look good' and others 'look bad'." **J.L.S.**