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The Woman CPA

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Editor's Notes

Opinion Shopping

In its Release 33-6594, the Securities and Exchange Commission has requested public comment on an issue called "opinion shopping." When a corporation registered with the SEC shops around for an auditor who will give an opinion that supports the registrant's reporting objectives and those objectives are not in accordance with GAAP, the situation is called opinion shopping.

Second Opinion

Seeking a second opinion may or may not be related to opinion shopping. Obtaining a second opinion is considered desirable in the medical field; however, in accounting it is viewed with much skepticism. Accounting is considered an art and the broad guidelines of GAAP do not provide an exact answer for all situations—particularly as new types of transactions and events arise. Management may honestly want another opinion on how to handle a transaction with no consideration for changing accountants.

If, however, management uses a second opinion as a means to influence the current accountant to produce what management desires, or lose the client, then an undesirable situation exists. Seidman and Seidman calls this "repugnant."

Independence

A change in auditor, when such change has been preceded by disagreements, may cast suspicion of bias on the new auditors. Any such perception of bias by the public for an auditor to succumb to client presure casts doubt upon the auditor's independence. An auditor who appears biased will lack independence if not, in fact, in the minds of the public.

If the registrant has shopped for an auditor willing to bow to the client's wishes and the results are materially misleading financial statements, both the registrant and the auditor may find themselves in violation of certain sections of the securities acts.

Firm Reaction

In general, the large public accounting firms appear to be against the SEC taking regulatory action on opinion shopping. Some firms believe there is no immediate problem.

Deloitte Haskins & Sells believes "the regulation of opinion shopping by a governmental body is not necessary. Any effective regulatory effort directed toward curbing opinion shopping must include a definition that clearly sets forth the circumstances as to when an accountant has been 'shopped' . . . Regulation could at best be implemented only on a broad policy basis, a solution we believe is inferior to the more effective self-regulation efforts of the accounting profession."

Seidman & Seidman believes the SEC should recognize the difference between abusive opinion shopping and the legitimate solicitation of second opinions. Opinion shopping "can have a pervasive adverse effect on the public's perception of the integrity of corporate reporting and the accounting profession. Therefore, it should be dealt with severely by both the accounting profession and the Commission."

Proposed Deterrants

The SEC is considering three approaches. The first, when there is a change in accountants, would require the registrant to disclose the solicitation of opinions from other accountants or to disclose if the successor accountant expressed an opinion different from the predecessor accountant. The second approach would require registrants to disclose any accountant other than the current one. The third approach would require a letter to accompany any changes in accounting principles and to name the accounting firms consulted.

Effective January 1, 1986 AICPA SECPS members must document any consultations on the application of GAAP within the firm and with predecessor firms. Peer reviewers must examine such documentation and test compliance with the firm's policies and procedures.

The AICPA's special committee on standards of professional conduct is proposing a mandatory quality assurance review program to improve work performance. The committee also is recommending adoption of a mandatory CPE program for all members and that the existing Code of Professional Ethics be replaced with a code of professional conduct.

Conclusion

It is difficult to assess the pervasiveness of opinion shopping. Three cases have appeared in all of my reading. Many judgmental factors and not clearly defined issues seem to be involved. If the accounting profession acts quickly and deals with opinion shopping through its own regulatory bodies on a preventable basis, the SEC may be forestalled from issuing another regulation. Ω

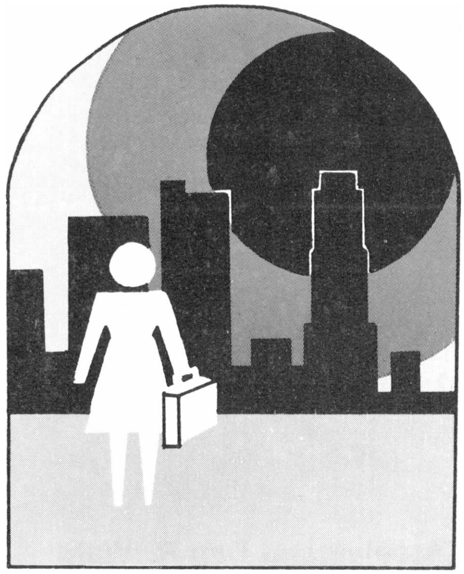
Two New Associate Editors

Carole Cheatham, CPA, Ph.D., professor of accounting at Mississippi State University, was chosen to fill a new position of associate editor-special features created July 1, 1985 to ensure a better balance between technical and nontechnical articles in our journal. She holds a doctorate from the University of Arkansas and has served on TWCPA staff in various positions for many years.

Roland L. Madison, CPA, Ph.D., professor and chairperson of the department of accounting at John Carroll University, Cleveland, Ohio, assumed the duties of associate editor-manuscripts on January 1, 1986. He holds the Ph.D. from the University of Nebraska-Lincoln and has served on the staff of TWCPA as nonbusiness editor since 1983.

Glenda E. Reed

ASWA Spring Conference



Hyatt Regency Columbus, Ohio May 8-10, 1986

The Columbus Chapter of ASWA will host the 1986 National Spring Conference.

Rosita Perez of Creative Living Programs, Inc. will be the keynote speaker. Her topic will be "A Close Encounter of the Musical Kind." Recognized as one of the most dynamic, unique and humorous speakers in the country, Rosita speaks of living life abundantly and creatively with musical modules that explore human behavior.

The conference will feature more than 40 speakers presenting sessions on technical topics and professional development. Topics to be presented include:

- Audit Sampling Techniques
- Computer Crime and How to Solve It
- Evaluating a Tax Shelter
- Financing a Small Business
- Effective Speaking
- Microcomputer and Software for Small Business
- Real Estate Accounting
- Small Business Going Public.

A pre-conference dinner will be held Wednesday evening, May 7 at the Crawford Inn, located at the Ohio Village, a historical area resembling an Ohio village in the early 1900's. Entertainment will be provided by the Madrigal Singers dressed in costumes of the period.

An evening at Scioto Downs will be the entertainment for Thursday, May 8. Scioto Downs features harness racing on the fastest five-eighths mile oval in the world. Dinner will be at the Clubhouse, a unique open-air restaurant at trackside.

A real "Hoedown" will take place at the Heimat Haus on Friday evening, May 9. There will be a demonstration square dance set, a caller, and a band for some great fun—square dancing. A delicious country "family style" dinner will be served.

The conference will close on Saturday evening, May 10, with an elegant dinner at the Hyatt Regency. The Zivili Dancers, a Yugoslavian folk dance group, will present a program of singing, dancing, and narration in native costume.

Several pre- and post-conference tours will offer an opportunity to see beautiful and historic Ohio. On Monday, May 5, there will be a pre-conference "Columbus Sight-Seeing" tour of downtown, the Avenue of Flags, and on to German Village, the largest private restored area of its kind in the U.S. Another tour also on Monday, "A Touch of the Orient," takes you to Westerville, Ohio to visit the Japanese Tea House complex.

On Tuesday, May 5 you can tour Holmes County, the largest Amish settlement in the country. The "Big 'O' Tour," held Wednesday May 7, will include the Ohio Theatre, Ohio State University and Ohio Village.

A post-conference tour to Marietta, Ohio, held on Sunday May 11 will be by way of the beautiful rolling hills and forests of southern Ohio. The tour will feature a ride on a riverboat and a tour of the Ohio River museum.

Plan now to attend the 1986 ASWA Spring Conference.

The Woman CPA: A Question of Job Satisfaction

Overall Attitude is Extremely Favorable

By Suzanne P. Ward, Owen B. Moseley and Dan R. Ward

Women have emerged as a vital and increasing segment of the work force with over 60 percent of single women and approximately 50 percent of married women employed. Long a source of industrial and clerical labor, women are now entering into the arena of the professional in accelerating numbers. With over 50 percent of incoming college freshmen being female, the potential impact on traditionally male-dominated fields such as accounting is enormous. In fact, the ranks of recently certified public accountants are comprised of increased numbers of women and the nation's accounting programs are now composed predominately of female students.

This increased participation of women in accounting highlights a need to understand and evaluate the level of job satisfaction being obtained by female CPAs. Job satisfaction, encompassing the attitudes/feelings that a female CPA has toward her job and work environment, results from her individual assessments, needs, preferences, and expectations. The female CPA's favorable outlook on life in general, satisfaction in and with her work environment, increased productivity, decreased absenteeism and turnover, and positive attitude toward her profession and employer provide worthwhile goals for the accounting profession. An awareness of the job satisfaction obtained by female accountants provides one possible source of guidance in achieving such goals and recognizes that the ultimate success of the profession is directly related to the attitudes and commitment of its members.

Previous research into job satisfaction focuses primarily on the measurement of job satisfaction obtained by general employees and various predictions based on satisfaction measures. The majority of accounting job satisfaction studies relate to accountants in general, with only limited research conducted relative to the degree of job satisfaction obtained by women Certified Public Accountants. This study examines this neglected area to provide a greater understanding of the dimensions underlying such satisfaction and, hopefully, aid in the improvement of the quality of work life for female CPAs.

The Measurement of Satisfaction

Job needs/satisfaction cannot be measured by a direct query concerning an individual's degree of fulfillment/satisfaction with a particular situation. The multi-dimensional characteristics affecting/determining satisfaction must be incorporated into the measuring instrument. The instrument must be capable of capturing individual perceptions relating to different facets of need/satisfaction attainment.[1]

The primary research into the measurement of job satisfaction was conducted by Smith, Kendall, and Hulin who developed the Job Descriptive Index (JDI).[2] Based on extensive research, the JDI is designed to elicit and measure employee satisfaction concerning their work environment within five key areas: (1) general nature of work, (2) supervision, (3) coworkers, (4) promotion, and (5) pay. The format of the JDI is that of short descriptive adjective statements designed to elicit responses for specific areas of satisfaction rather than global satisfaction with work-oriented rather than self-oriented responses sought.[3] Because the JDI has been subjected to extensive validation, this instrument was the measurement device utilized in this study.

Methodology of the Study

The examination of job satisfaction of professional women accountants was conducted via a survey of female CPAs employed in the United States. A questionnaire containing the JDI and related background questions was mailed to a random sample of women accountants as listed in the *Directory of Members* of the American Woman's Society of Certified Public Accountants. Two hundred twenty-nine responses were obtained providing an overall response rate of forty-eight percent.

The JDIs were scored and statistically analyzed resulting in a satisfaction index for each subject in each of the five key dimensions of job satisfaction. Stratification of respondents' scores by income level, geographic region, age, and employment category was performed to determine if these selected background variables were significant to the measures obtained from the JDI. In addition, the five dimensions of job satisfaction measured for the professional woman accountant were compared with those found in previous studies involving male/female management accountants and female general employees.

The Job Descriptive Index

The five areas covered in the JDI are presented in the accompanying bar charts which allows a comparison of levels of job satisfaction among groups. The data regarding accountants employed by manufacturing firms is from a study by Seiler and Sapp consisting of 1338 male/female respondents from all organizational levels.[4] The female general employee data, from a study conducted by Smith, et al, includes 643 female employees from 21 plants.[5] The data from all studies was converted to a common measurement scale to allow for comparability.

The following tables are presented for reader information and comparative purposes; an individual score is neither "passing" nor "failing." For example, a score of 30 for Pay is useful only when compared to the score of another individual or group. The expected JDI scores under various assumptions are presented in Table 1. The reader should keep in mind that a score of 18 represents indifference and a score of 27, a balanced attitude toward job satisfaction.

Table 2 presents the respondents' JDI scale statistics. Overall, female CPAs appear to be satisfied with their job and work environment. This is evidenced by the mean scores for all five dimensions exceeding both the indifference and balanced attitude scores presented in Table 1. However, women accountants are most satisfied with supervision and co-workers and least satisfied with their promotional opportunities and pay.

An examination of Table 3 further highlights the relative areas of satisfaction/dissatisfaction of female CPAs. At the 25th percentile, two dimensions (promotion and pay) present potential areas of job dissatisfaction with promotion being the area of primary concern. Promotion and pay continue to be areas of concern at the 50th percentile, but with a decreasing degree of relative discontent.

While work and supervision appear to be the most satisfying aspects at the 25th percentile, at the 50th and 75th levels supervision and co-workers provide the most satisfaction. The fact that pay and work have the lowest relative scores at the 75th percentile may be an indication that the profession/employers are less effective in equitably integrating female CPAs into the

TABLE 1
JDI EXPECTED SCORES UNDER VARIOUS ASSUMPTIONS[a]

		Expected Scores Under Assumption of			
			Response Set		
Scale	Max Score	Indifference	Yes	No	Balanced Attitude
Work	54	18	30	24	27
Supervision	54	18	30	24	27
Co-Workers	54	18	24	30	27
Promotion	54	18	30	24	27
Pay	54	18	24	30	27

[a]Smith, et al, page 81.

TABLE 2
FEMALE JDI SCALE STATISTICS

Scale	Mean	Mode	Median	Maximum	Minimum	Std. Dev.
Work	37.7	39.0	39.0	54.0	9.0	8.23
Supervision	40.0	54.0	42.0	54.0	2.0	12.82
Co-Workers	40.2	51.0	43.0	54.0	4.0	12.10
Promotion	29.8	54.0	29.0	54.0	0.0	18.24
Pay	32.7	36.0	36.0	54.0	0.0	13.86

TABLE 3
PERCENTILE POINT SCORES FOR JDI DIMENSIONS

Percentile Point	Work	Supervision	Co-Workers	Promotion	Pay
25 percent	34.0	33.0	32.0	16.0	24.0
50 percent	39.0	43.0	43.0	28.0	36.0
75 percent	43.0	51.0	51.0	48.0	42.0

FIGURE 1
SATISFACTION WITH NATURE OF WORK

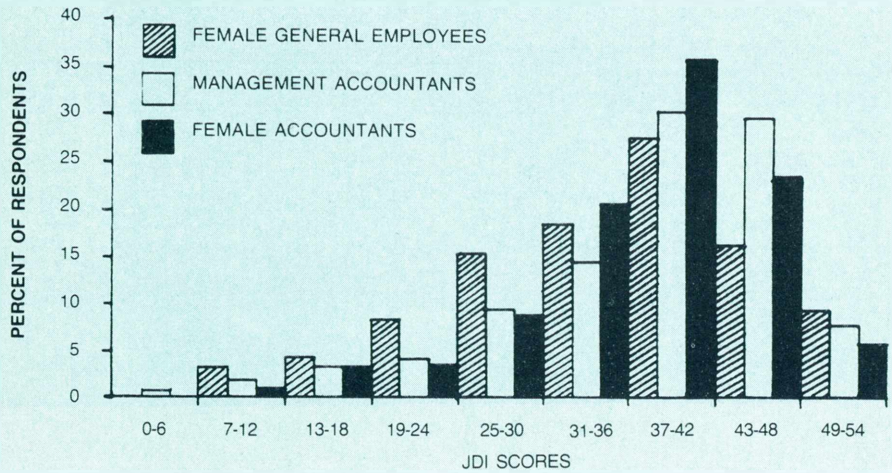
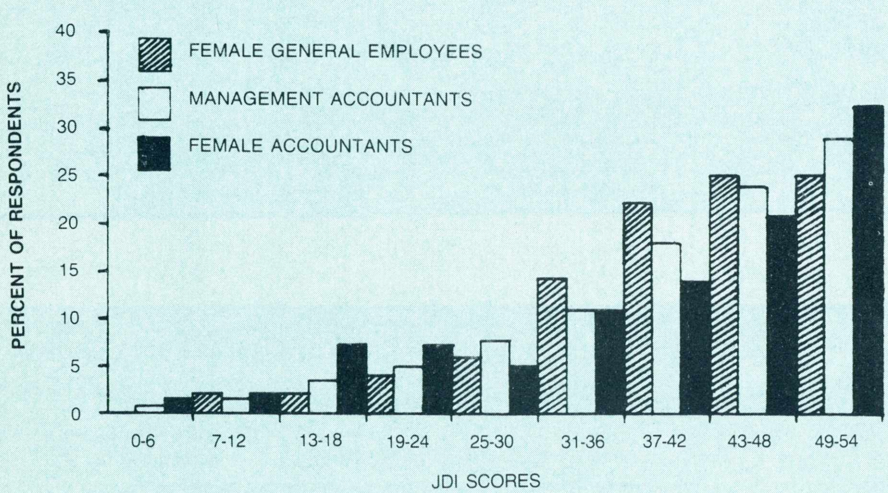


FIGURE 2
SATISFACTION WITH SUPERVISION



field than in achieving other, perhaps less difficult, aspects of job satisfaction. A discussion of each of the five key dimensions of job satisfaction is now presented.

Nature of Work

Female accountants appear moderately to highly satisfied with the nature of their work. This is evidenced by a mean JDI score of 37.7 (Table 2) and the fact that over 80 percent of the respondents rated their work satisfaction above 27 (expected balanced attitude score). While all three groups exhibited relatively high work satisfaction (Figure 1), the greater number of female CPAs and management accountants reporting high levels of work satisfaction may be a reflection of the professionalism inherent in accounting as previously suggested by Seiler and Sapp.[6] However, at the extremely high levels of satisfaction with one's work, 43 and above, female CPAs are relatively much less satisfied than their management accountant counterparts.

Supervision

In general, all three groups appear to be very highly satisfied with their level of supervision and/or type of supervisor. As exhibited in Figure 2, the supervision curve for scores 25 or greater is depicted by an upward sloping curve to the right indicating increasing numbers of highly satisfied individuals. This suggests that satisfaction with one's level/style of supervision is less a function of job classification and more a function of the individual supervisor. However, a disturbing note is indicated by nearly one in four of the female CPAs reporting ratings of indifference or dissatisfaction with supervision as compared to approximately one in seven for general employees and one in five for management accountants.

Co-Workers

Accountants and general employees indicate that they are highly satisfied with the individuals with whom they are working, as presented in Figure 3. The co-workers scores for female CPAs closely parallel their scores for supervision. However, if one accepts a rating of less than 18 (the point of indifference) as being indicative of a high level of dissatisfaction, then almost twice as many of the female accountants are more highly dissatisfied than the management accountants or the female general employees.

These observations are also reflected by the slopes of the curves for all three groups. The general employees' and the management accountants' curves slope upward to the right indicating increasing levels of satisfaction, while the curve representing female accountants reflects a moderate number of individuals who are either indifferent or neutral with respect to their feelings toward the people with whom they associate in the work environment. One may speculate that the causal factors underlying the female accountants' lower satisfaction with co-workers may reflect (1) an inability to effectively establish a sense of camaraderie with male counterparts, and/or, (2) an inability or lack of sufficient desire to establish interpersonal relationships with co-workers in a highly competitive professional work environment.

Promotion

Professional female accountants and management accountants expressed a much higher level of satisfaction with perceived promotional opportunities than did general employees. This is not surprising in that career advancement possibilities in the professions tend to be more numerous and attainable than in non-skilled or blue-collar fields. However, as presented in Figure 4, female accountants and management accountants tend to be either highly satisfied or highly dissatisfied with their promotional possibilities with female accountants exhibiting the greatest degree of polarity. The area of promotion provided the least satisfaction of all five dimensions to the female CPAs as evidenced by a mean score of 29.8, only slightly better than a balanced attitude (Table 2). Satisfaction with promotion also ranked lowest at the 25th and 50th percentile points (Table 3). Thus, female CPAs, while perceiving more favorable promotional opportunities than general employees, still profess to feel less positively toward their ability to achieve professional advancement than management accountants.

Pay

In general, all groups appear to be relatively less satisfied with their pay than any of the other four dimensions of job satisfaction. The curves in Figure 5 are similar for female accountants and female general employees and exhibit the properties of the bell-shaped, normal distribution curve. The majority of both groups are generally satisfied with pay with female accountants being slightly more satisfied, possibly reflecting the higher salary potential in the professions. However, the curve for management accountants is skewed to the right, indicating higher levels of satisfaction than for the other two groups. This result suggests that females across a wide range of occupations may be less satisfied with their salary level and potential than their male counterparts.

FIGURE 3
SATISFACTION WITH CO-WORKERS

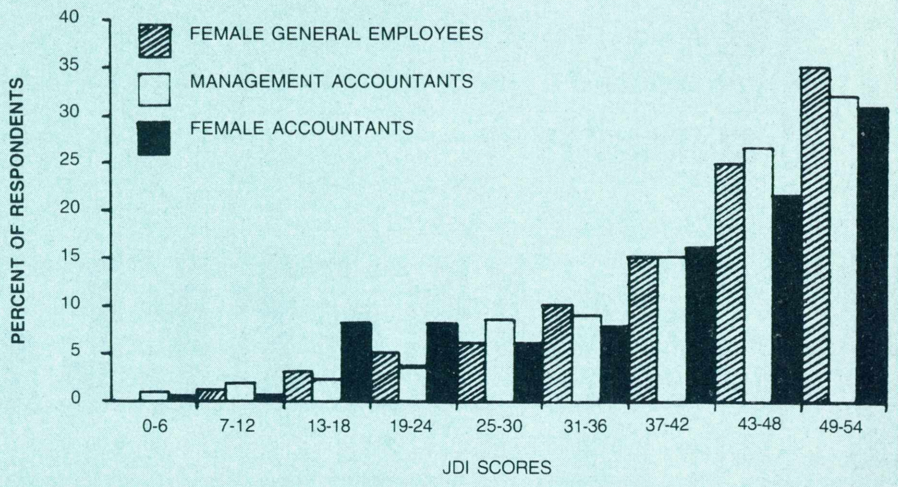
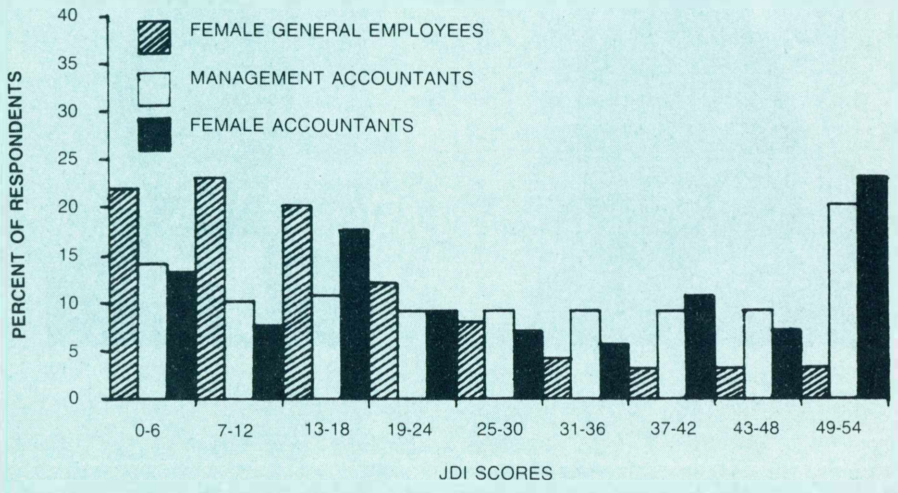
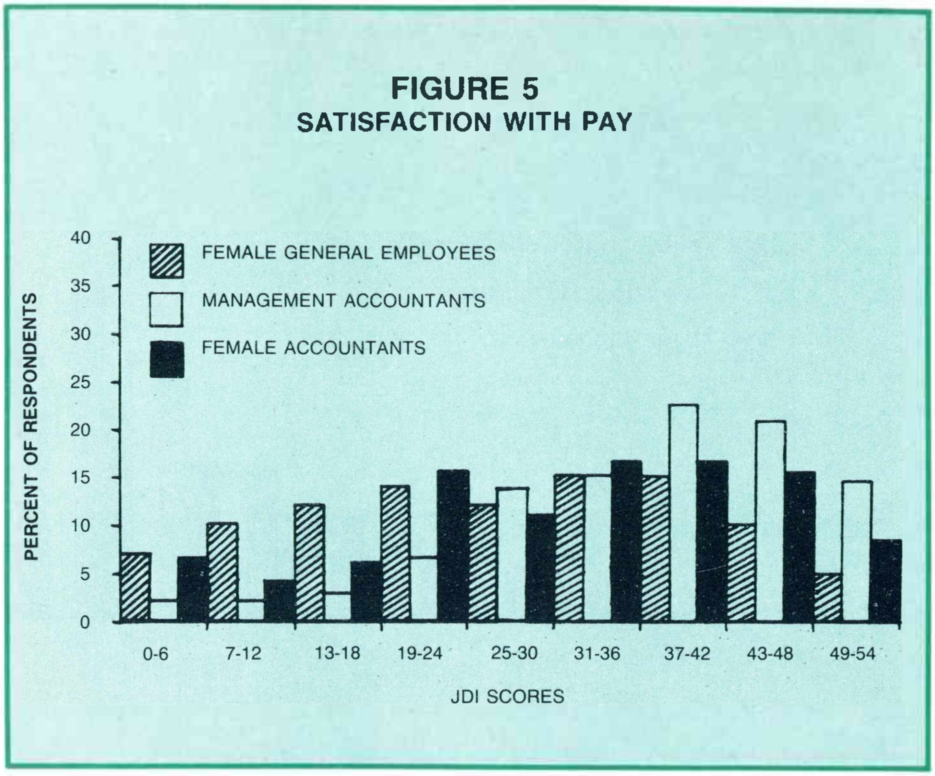


FIGURE 4
SATISFACTION WITH PROMOTION





Statistical Analysis

To determine the relationship between the background data supplied by the female accountants and their JDI scores, an analysis was undertaken utilizing the appropriate one-way analysis of variance (ANOVA) or students t-test technique. A significance level of 0.05 and, where appropriate, two-tailed test of the hypothesis was used. Table 4 presents the results of the analysis.

Stratification of JDI scores by age indicated that three dimensions of job satisfaction (nature of work, supervision, promotion) were significant. Younger respondents (below age 30) reported the lowest satisfaction ratings for the nature of work. This finding is not unexpected in that at the onset of one's career a drastic change in lifestyle occurs (relatively unstructured college life vs. highly structured job scenario) coupled with the anxiety of the job selection process. The satisfaction scores for work increase, again as

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Owen B. Moseley, Ph.D., CPA, *is professor of accounting at Murray State University, Murray, Kentucky. He is a member of the AICPA, AAA, NAA, and the Academy of Accounting Historians.*

expected, with job familiarity and career advancements and begin to decrease slightly toward the end of the work years.

Older female accountants exhibited significantly less satisfaction with their supervision and promotion possibilities than did their younger counterparts. This is plausible if one accepts a desire for less supervision (detailed control) and a declining range of opportunities for promotion after professional and/or individual maturation. The satisfaction scores for pay, while significant at $\alpha = 0.10$, tend to follow the same general pattern as those of supervision and promotion.

In summary, while age affect four of the five measured dimensions of job satisfaction, all age groups reported moderate to extremely high satisfaction with all five dimensions. The results reported tend to follow the normal job satisfaction curve.

Respondents' JDI scores from the six geographic regions within the United States were compared to determine if differences existed due to geographical location. Only satisfaction with nature of work exhibited a significant variation with female accountants in the Southeast, West, and Midwest reporting higher levels of satisfaction than those in the other three regions.

Significant differences were indicated as a result of income stratification. First, satisfaction ratings with promotion and pay appear to be directly related to income levels. At the lowest income level, this may be a reflection of the disappointment resulting from undue salary and/or entry-level position optimism common to recent graduates/additions to the profession. At the upper end of the income strata, these high JDI scores may reflect either (1) satisfaction with having achieved the highest remuneration possible and the ultimate status position, partner in a CPA firm, or (2) a significant downward adjustment of career potential and a realistic assessment of abilities, desires, and real possibilities existing within the firm/profession.

Secondly, indifference and/or dissatisfaction with pay and promotion do not reflect a similar dissatisfaction with work (i.e., chosen profession). Female CPAs earning less than $15,000 reported the highest JDI scores with

TABLE 4
COMPARISON OF STRATIFIED JDI SCORES

	MEAN JDI SCORES				
AGE (YEARS)	NATURE OF WORK[a]	SUPERVISION[b]	CO-WORKERS	PROMOTION[c]	PAY[d]
Below 30	37.8	43.2	41.5	32.9	35.7
30 - 39	35.9	40.1	39.6	31.2	32.8
40 - 49	40.7	37.0	42.7	23.4	27.8
50 - 59	40.5	33.4	37.7	13.8	29.8
60 and over	39.4	28.5	33.0	26.4	34.2

[a] significant at $\alpha = 0.017$
[b] significant at $\alpha = 0.010$
[c] significant at $\alpha = 0.016$
[d] significant at $\alpha = 0.061$

	MEAN JDI SCORES				
REGION	NATURE OF WORK[e]	SUPERVISION	CO-WORKERS	PROMOTION	PAY
Northwest	35.9	41.7	35.9	29.6	30.7
Mid-Atlantic	35.9	39.4	39.9	29.2	35.1
Southeast	40.1	40.4	41.5	28.8	33.8
Midwest	37.9	37.8	41.5	27.2	33.6
Southwest	35.7	39.5	37.1	29.2	32.1
West	38.6	43.1	43.4	36.0	31.0

[e] significant at $\alpha = 0.073$

	MEAN JDI SCORES				
ANNUAL INCOME	NATURE OF WORK	SUPERVISION	CO-WORKERS[f]	PROMOTION[g]	PAY[h]
Less than $15,000	40.5	47.0	35.3	18.0	19.0
$15,000 - 19,999	38.8	37.3	38.4	26.0	27.8
$20,000 - 29,999	36.9	40.5	38.8	26.8	29.2
$30,000 - 39,999	37.9	39.8	40.3	29.4	37.2
$40,000 - 49,999	37.6	42.0	46.3	37.2	36.9
$50,000 and over	38.7	37.0	45.0	39.8	41.6

[f] significant at $\alpha = 0.070$
[g] significant at $\alpha = 0.039$
[h] significant at $\alpha = 0.000$

	MEAN JDI SCORES				
EMPLOYMENT TYPE	NATURE OF WORK	SUPERVISION	CO-WORKERS	PROMOTION[i]	PAY
Public	37.6	39.5	41.4	34.4	31.6
Non-Public	37.9	40.6	38.6	24.7	34.2

[i] significant at $\alpha = 0.000$

respect to nature of work. The decrease in work scores reported by the next two income levels followed by increases over remaining levels may indicate an expected adjustment to incorporate the realities of the workplace.

Satisfaction with co-workers (significant at $\alpha = 0.10$) also tends to increase as income levels rise. This may result from a closer working relationship with peers having similar outlooks, aspirations, and career goals.

When the respondents were divided into public and non-public categories, the only significant difference was for promotion. The female public accountants tended to exhibit higher levels of satisfaction for promotions than their nonpublic counterparts. This may be attributed to a greater number of promotional levels available in public accounting combined with a high degree of turnover yielding a greater incidence of promotional possibilities than in non-public accounting.

Conclusion

The world of the female accountant remains relatively unexplored. Accounting, a mentally stimulating and challenging profession, should assess the female accountant and her contributions to the field. With female accountants often perceiving male accountants as being more satisfied with and more rewarded by the profession,[7] the assessment of the job satisfaction attained by women accountants is of vital importance.

Female accountants appear to be relatively satisfied with all aspects of the work environment surveyed in this study. They indicated a very high level of satisfaction with co-workers and supervision and a moderately high level of satisfaction with the nature of their work. They were least satisfied with the pay and promotional opportunities available to them.

All stratification variables affected the female accountant's satisfaction with her work environment to some degree. First, younger female accountants reported the highest JDI scores for supervision, promotion, and pay. Thus women appear to enter the profession with an air of optimism and hope which is gradually eroded when faced with the realities of professional accounting. Secondly, female accountants in all regions of the United States appear highly satisfied with the nature of work, supervision, and co-workers. However, the JDI scores for each region reflect only moderate satisfaction with promotion and pay. Thirdly, female accountants in the lower income categories are less satisfied with their co-workers, promotion possibilities, and pay. This, perhaps, reflects the competition inherent in entry-level positions. Lastly, the higher scores for non-public accountants in the areas of nature of work, supervision, and pay may be attributable to the perceived or actual association of less stress and responsibilities in private accounting. Female public accountants tended to exhibit higher levels of satisfaction for promotion, thus reflecting an increased coincidence of promotional expectations with actual career realities.

With more females challenging the traditional role structure in accounting, the females' overall attitude toward this previously male-dominated field is extremely favorable. The perception that a demanding career equates to satisfaction with one's job perhaps impels women not only to enter accounting, but also to recommend the profession to other females. This study has attempted to provide guidance toward the goal of attaining the highest level of job satisfaction possible for female accountants. The analysis of areas implying high/low levels of job satisfaction hopefully provides a basis which accounting firms may use to adjust those factors under their control.Ω

NOTES

[1]P. Smith, L. Kendall, and C. Hulin, *The Measurement of Satisfaction in Work and Retirement: A Strategy for the Study of Attitudes* (Rand McNally and Company, 1969).

[2]Smith, et al.

[3]Smith, et al.

[4]R. Seiler and R. Sapp, "Just How Satisfied Are Accountants with Their Jobs?," *Management Accounting* (March, 1979), p. 18-21.

[5]Smith, et al.

[6]Seiler and Sapp.

[7]T. Melcher and R. Welker, "Women in the Profession: An Appraisal," *The Woman CPA* (October, 1980), p. 18-23.

The Woman CPA is indexed in *The Accountants Index* and *Management Contents.* It also is available in microfiche from University Microfilms International and in printed form from UMI Article Clearinghouse, each in Ann Arbor, Michigan, 48103.

Home Office Deduction Allowed for University Professor

Second Circuit Reverses Tax Court

By Chula G. Ensley

The U.S. Court of Appeals, Second Circuit, has recently held in Weissman v. Commissioner[1] that, under some circumstances, a university professor is entitled to a home office deduction for the working area in his apartment used for university related activities. In so holding, the Second Circuit reversed a consistent Tax Court position that the principal place of business, i.e., focal point of the business activities, of a university professor as specified in Sec.280A(c)(1)(A) is the university campus. While the Weissman decision is relatively narrow in scope, many university professors may benefit therefrom.

Section 280A

Section 280A, enacted as part of the Tax Reform Act of 1976, generally disallows a deduction for office space used within a dwelling unit which is the employee-taxpayer's residence, unless specifically excepted from this section and otherwise allowable. An exception to this disallowance is found in Sec.280A(c) which provides that the employee-taxpayer shall not be denied a home office deduction if four conditions are met. First, the use of the portion of the dwelling unit serving as an office must be exclusive. Second, the use must be on a regular basis. Third, the portion of the dwelling unit under question must be the principal place of business of the taxpayer. Finally, such use must be for the convenience of the employer.

The legislative history of Section 280A indicates that the exclusive use test requires that the taxpayer's use of the portion of the dwelling unit be solely for the purpose of carrying on his trade or business. The Senate Report indicated that using a room in the house for both personal and business purposes would not satisfy the exclusive use test.[2] However, the Tax Court in Weightman v. Commissioner[3] found that a college professor who used a portion of his bedroom as a home office had satisfied the exclusive use test even though such portion was not physically separated from the rest of the bedroom. In so holding the Tax Court concluded that Sec.280A(c) does not require a separate room or some physically separated portion of a separate room. However, the Court indicated that without a wall, partition, curtain or some other means of identifying the business area, the taxpayer may have more difficulty establishing that there was in fact some separate, though unmarked, area that he used exclusively and on a regular basis as his home office.

In discussing the regular basis requirement, the Senate Report[4] indicated that a home office used only occasionally or incidentally would not be considered as used on a regular basis. The proposed regulations do little to provide further guidance. Proposed Regulation Sec.280A-2(h) merely states that the regular basis requirement is decided in light of all the facts and circumstances of the individual case. The scant authority, however, suggests that a taxpayer who establishes a consistent pattern of behavior in which the home office is an integral part of his business activities, will satisfy the regular basis requirement.

The principal place of business requirement looks to the "focal point" of the taxpayer's business activities. The proposed regulations under Sec.280A provide that:

> When a taxpayer engages in a single trade or business at more than one location, it is necessary to determine the taxpayer's principal place of business for that trade or business in light of all the facts and circumstances. Among the facts and circumstances to be taken into account in making this determination are the following:
>
> (i) The portion of the total income from the business which is attributable to activities at each location;
>
> (ii) The amount of time spent in activities related to that business at each location; and
>
> (iii) The facilities available to the taxpayer at each location for purposes of that business.[5]

Neither the legislative history of Sec.280A, nor the proposed regulations thereunder shed much light on the convenience of the employer requirement. The legislative history provides only that the deduction attributable to the home office use will be denied if such use is merely appropriate and helpful. The Fourth Circuit held in Bodzin[6] that in order to establish that the use of the home office was for the convenience of the employer, the taxpayer must show that the office provided by the employer was either not available at the time the home office was used or not suitable for the purpose for which the home office was used.

Weissman v. Commissioner

This case involves the question of deductibility of a home office maintained by David J. Weissman, an associate professor of philosophy at City College of the City of New York. Professor Weissman was required not only to teach, but also to conduct an unspecified amount of research and writing in his field in order to retain his teaching position. Of the 64 to 75 hours per week Professor Weissman spent engaged in his profession, only 14 to 15 hours per week or 20 percent was actually spent on campus. The remaining 80 percent of his working hours was spent in an office maintained in his ten-room apartment. The on campus office provided Professor Weissman by the university contained no typewriter, was shared with several other professors and was found by the Tax Court to be an unsafe place to leave his teaching, writing and research related materials and equipment. Professor Weissman also had access to the school library from 9:00 a.m. to 9:00 p.m. on weekdays. However, the library provided no space for typing manuscripts and no private space in which to work.

Based upon the facts in the case, the Tax Court accepted Weissman's argument that the office in his apartment was used exclusively and on a regular basis for his employment related activities of research and writing. However, the Tax Court denied Weissman's argument that the home office was the focal point of his business activities. In so concluding, the Tax Court stated that:

> We have uniformly held that the focal point of those who teach (at both college and secondary school levels) is the educational institution rather than the home office. While research and writing was an important part of petitioner's duties as an associate professor, it does not shift the focal point of his job away from City College where he taught, met with students, graded examinations, and prepared lectures. This is so even though petitioner spent more time each week doing research and writing at home than he spent in teaching and related activities at the college.[7]

The Tax Court denied Weissman's argument that the maintenance of the home office was for the convenience of his employer. The Tax Court based this opinion first on the fact that the university bylaws did not require the employee to maintain a home office and secondly on the basis of testimony of the assistant chairman of the philosophy department that the library could have been used in some of Weissman's research.

The Weissman decision permits a home office deduction for a University professor who is required to engage in research and writing, spends the majority of his working time doing so, and is not provided adequate on-campus office space for these activities.

The Second Circuit, however, rejected the Tax Court's opinion that Weissman not be allowed the home office deduction because of failure to meet the principal place of business and convenience of employer tests.

In its opinion, the Second Circuit questioned the Tax Court's focal point approach to determining a university professor's principal place of business.

> In the case of educators, the focal point approach does not always adequately distinguish between individuals with very different employment activities. No doubt many college professors spend most of their working hours teaching or engaging in teaching-related activities . . . . Some college professors, however, spend the major share of their working hours researching and writing. Both types of employee have earned the designation of "professor," but the title should not obscure the differences between them. In this case, the Tax Court focused too much on Professor Weissman's title and too little on his activities.[8]

The Second Circuit cited Drucker v. Commissioner[9] in which the Court used the following criteria to determine the principal place of business: (1) the nature of the business activities; (2) the facilities needed to carry out such activities; and (3) the practical necessity of using a home office.

In applying Drucker to the instant case, the Second Circuit determined that the nature of Professor Weissman's business activities was 20 percent teaching related and 80 percent research and writing related. The research and writing related activities required a place in which Professor Weissman could read, think and write without interruption. Since he was not provided a private on campus office in which to conduct the research and writing activities, a home office was a practical necessity. Thus, applying the Drucker case along with the fact that scholarly research and writing were conditions of Professor Weissman's continued employment, the Second Circuit concluded that the principal place of business requirement was met. In so concluding, the Court added the following caveat:

> In some circumstances the fact that a professor spends a majority of his working time in his home office will not overcome the presumption that an educator's principal place of business is the college at which he teaches.[10]

The Second Circuit likewise applied the Drucker case in reviewing the "convenience of the employer" requirement. In Drucker, the Court concluded that this requirement had been met because the appellants, who were musicians, had not been provided any space for the essential task of private practice, and because the expenses were not solely for personal convenience, comfort, or economy. Applying the Drucker standard, the Court concluded the following:

> The cost of maintaining his home office was almost entirely additional to nondeductible personal living expenses because it was used exclusively for employment-related activities and because such use was necessary as a practical matter if Professor Weissman was faithfully to perform his employment duties. This practical necessity negates any claim that the office was used as a matter of personal convenience rather than for the convenience of the employer. . . . The maintenance of a home office was not a personal preference of the employee; it spared the employer the cost of providing a suitable private office and thereby served the convenience of the employer.[11]

Unresolved Issues

The Weissman case leaves three points unresolved: (1) Whether a lesser quantity, i.e., less than 80 percent, of working hours spent at the home office would satisfy the principal place of business requirement; (2) to what extent, if any, the professor could use the home office to engage in activities for which adequate on campus facilities were provided, e.g., grading papers; and (3) whether the presence of all three factors of unsafe campus conditions, lack of private office space and lack of private library space were required to establish the necessity of a home office.

Application of Weissman

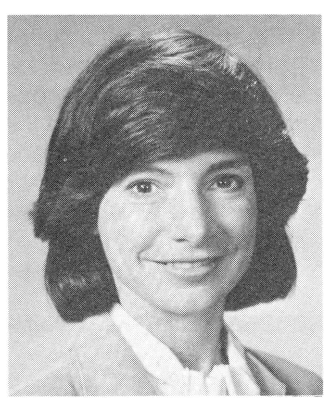
In General. The decision reached in Weissman would permit the home office deduction for a university professor who (1) by conditions of his employment, is required to engage in scholarly research and writing, (2) spends the majority of his working time engaged in scholarly research and writing, and (3) is not provided adequate on campus office space in which to conduct scholarly research and writing.

A percentage of the following deductions is available to a professor who maintains a home office: (1) depreciation on the dwelling if the professor is a home owner, or the rental payment; (2) home mortgage interest; (3) real estate taxes; (4) insurance; (5) utilities; (6) alarm system; (7) telephone; (8) cleaning expense; and (9) some types of minor repairs. This percentage is generally based on the ratio of the square footage of the home office to the square footage of the total dwelling. In addition, the following deductions not requiring allocation are available: (1) depreciation and investment tax credit on furnishings and equipment used in the home office; (2) supplies; (3) painting home office space; (4) office equipment repairs; (5) new curtains/drapes in space used as home office; (6) personal property taxes on office equipment, furnishings and equipment; and (7) other normal office operating expenses.

Under Sec.280F of the Tax Reform Act of 1984. Weissman may have special significance to a university professor when viewed within the context of Sec.280F, added by the Tax Reform Act of 1984. Sec.280F generally denies an employee a deduction for and investment tax credit on certain "listed" properties used for trade or business purposes unless the use is both for the convenience of the employer and required as a condition of employment.[12] Included in the definition of "listed" properties are computers and peripheral equipment, and automobiles.

In most instances, a university professor would have difficulty under Sec.280F deducting the cost of a computer and peripheral equipment used at home. However, Sec.280F(d)(4)(B) excludes from the definition of "listed" property any computer or peripheral equipment used exclusively at a regular business establishment. Such section treats the home office as a regular business establishment if the requirements of Sec.280A(c)(1) are met. Therefore, a university professor who is able to substantiate a home office deduction under Sec.280A as outlined in Weissman should be allowed a depreciation deduction on and investment credit for a computer and peripheral equipment used therein.

Another significant deduction available to the professor who maintains a home office is the cost of commuting between the home office and campus. The Tax Court held in Curphey v. Commissioner[13] that a taxpayer may deduct the transportation expenses incurred in traveling between his home and other business locations when the taxpayer's home is his principal place of business with respect to those business activities. While the university professor may or may not be denied a depreciation deduction and investment tax credit on his automobile under Sec.280F, he should be entitled to the standard mileage allowance for travel between his home office and the university campus if he qualifies for a home office deduction under Sec.280A(c)(1).



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Substantiation of Home Office Deduction

The university professor who is eligible to take a home office deduction should have adequate records for substantiation thereof. These records should contain the following:

1. A statement by the employer reciting scholarly research and writing as a condition of continued employment and promotion.
2. Documentation of on campus facilities for carrying out scholarly research and writing to support both the necessity of having a home office and the convenience of the employer requirement.
3. Documentation of the working hours spent on campus and the working hours spent in the home office to support both the amount of time and the use of the time at both locations, to support the principal place of business requirement, and to support the regular use requirement.
4. Documentation of the furnishings of the home office to support the deductions thereon and the exclusive use requirement.
5. Documentation of all activities carried out in the home office to support the exclusive use requirement.
6. Documentation to support the percentage used for allocating those deductions requiring allocation.

Conclusion

Prior to the Second Circuit's decision in Weissman v. Commissioner, university professors were generally denied a home office deduction. Such denial typically resulted from the Tax Court's finding that the principal place of business activity of a university professor is the university campus rather than the home office. Weissman more liberally applied this requirement

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Troubled Debt Restructuring

Accounting Rules Fueling the International Banking Crisis

By Sharon M. McKinnon and James F. Volkert

Some corporate debtors have problems satisfying their financial obligations during periods of depressed economic conditions or other financial hardship. Consequently, debt obligations are often restructured to permit the debtor either to defer or to reduce the interest or the principal obligation. There is considerable variety in the form these restructurings may take. Not surprisingly, in the absence of guidelines before 1977, there was also considerable variety in the ways that both debtors and creditors accounted for these events.

Statement of Financial Accounting Standards No. 15, effective for restructurings occurring after December 31, 1977, prescribes accounting treatment for both extinguishments and revised loan covenants of debts defined as "troubled." While the statement could be said to have resolved the consistency and comparability problems associated with troubled debt, its issuance did little to advance the FASB's claims as an impartial standard-setting body devoted to theoretical consistency.

Several issues merit a reexamination, over six years later, of the circumstances surrounding issuance of *SFAS No. 15*. First, economic events of the mid-1970's played a significant role in the promulgation of standards on troubled debt restructurings. These economic factors have loomed even larger in the early 1980's and provide a startling example of how accounting and reporting requirements can significantly interact with macroeconomic events. Second, the ability of one industry group to impose its viewpoint on the standard-setting process warrants analysis in retrospect of the consequences of the FASB's acquiescence. Third, in light of subsequent issuances in the FASB's conceptual framework project, the choices made in SFAS No. 15 appear all the more indefensible.

International debt crises are putting pressure on the World Bank to take action.

Historical Setting for SFAS No. 15

Several factors contributed to an increase in loan restructurings in the mid-1970's. The real estate market experienced a dramatic recession, much to the dismay of the commercial banks investing heavily in Real Estate Investment Trusts (REITs). Debt restructurings occurred as a result of tightening financial conditions. Compounding these problems was the fiscal distress of large entities such as Penn Central, W. T. Grant, and the city of New York.

In addition, banks had increased their foreign loans substantially. Large deposits of dollars by oil-producing countries allowed banks to loan dollars to developing countries. They in turn used the dollars to purchase oil, and dollars were again deposited by the oil-producers. This cycle dramatically increased the availability of dollar-denominated loans. In hindsight, the problems caused by liberal loans to developing countries appear easy to predict, but for several years the significant growth of many less developed countries postponed what now seems so inevitable.

Accounting Choices

Various events can occur when a debtor is faced with difficulties in fulfilling a debt obligation. One course of action is to settle the debt on some terms agreeable to both parties, usually resulting in an economic loss to the creditor. The creditor may believe that some lesser repayment is better than to chance losing the entire amount owed. Accounting and reporting of this type of definite transaction is relatively straightforward because the traditional accounting model "sees" the settlement as an income or expense recognition event within the standard accounting framework.

What is more difficult to address is a continuation of the debt with a modification in terms, generally consisting of a lower interest rate, lower principal amount, or extended time to repay. The nature of these concessions is that the debtor will economically benefit and the creditor will lose. Whether or not the concession itself is an event worthy of triggering immediate recognition of this loss was the controversial issue confronting the FASB in 1977.

Exhibit 1 provides a simple numerical example of how changes in terms can affect the present value of a loan. The original loan of $10,000 is recorded by both parties at its face value (ignoring complications such as discounted notes). In addition to being *face* value, this is also the *present* value of the loan, as demonstrated in the exhibit. Each of the three modifications in terms reduces the present value of the loan, yet in each the absolute amount of cash to be received over the life of the debt exceeds the original amount of $10,000.

Prevalent practice before 1977 for restructurings was *not* to change the carrying amount of the loan receivable to reflect a new present value unless the change was a reduction of principal. Instead of immediate recognition that a loss had occurred, future interest income was reduced. Most financial institutions, in many cases adhering to state or federal banking laws, take other steps to deal with problem loans. Accrual of overdue interest income ceases after a certain time. For example, New York banking laws prohibit recognition of interest income that is thirty days past the billing due date. U.S. regulations allow ninety days. Levels of allowances for loan losses are tied to estimates of potential loan portfolio risk and closely correlated to the amount of "non-performing" loans.

But banks have been particularly reluctant to recognize immediately the economic losses associated with restructuring. When the FASB issued a Discussion Memorandum in 1976 which addressed various suggested proposals for dealing with restructurings, the response from the banking industry was overwhelmingly negative. The Board received close to 900 letters of comment, most from bankers. According to Marshall Armstrong, then chairman of the FASB, most of the responses failed to discuss the issues, being "unreasoned protests against current value accounting."

Of the five alternatives in the Discussion Memorandum, four involved some approach to recognizing the current value of the loan receivable by using present value techniques. By focusing on the controversial terminology "current value," the banking industry tried to shift its arguments to a theoretical level. Most of the controversy surrounding "current value" accounting concerns difficulties in determining the worth of tangible assets. Debt obligations with fixed terms actually provide ideal examples of assets whose true value is quite easily determinable.

The arguments to postpone use of present value until formulation of a conceptual framework were merely window dressing for more pragmatic objections. All the current value methods would result in larger additions to loan loss reserves than the historical methods in use at that time. Federal Reserve regulations are quite strict regarding the size of these reserves. When a loan becomes a bad debt, the bank must adjust its loan loss reserves. These reserves act as offsets to banks' primary capital, of which American banks are required to maintain $1 for every $20 in outstanding loans. Because banks generally stay as close to that ratio as possible, writing off losses due to restructuring could reduce lending by some 20 times the capital loss. This threat of decreased income could discourage banks from renegotiating loans and have negative effects on firms in financial distress.

The FASB Reaction

The banking industry was granted a reprieve by the provisions of *Statement No. 15*, issued in June 1977. The FASB reacted to the negative response to its Discussion Memorandum by prescribing standards which

EXHIBIT 1

Terms of Original Loan: Principal-$10,000; Interest-12%; Term-5 years

Present Value:	Principal-$10,000 x .56743	= $ 5,674
	Interest-$1,200 x 3.60478	= 4,326
	Recorded amount of loan	$10,000

Modifications:

1. Change interest rate to 8 percent:

Present Value:	Principal-$10,000 x .56743	= $ 5,674
	Interest-$800 x 3.60478	= 2,884
		$ 8,558
Absolute amount of cash:	Principal	= $10,000
	Interest	4,000
		$14,000

2. Change principal to $8,000:

Present Value:	Principal-$8,000 x .56743	= $ 4,539
	Interest-$960 x 3.60478	= 3,461
		$ 8,000
Absolute amount of cash:	Principal	= $ 8,000
	Interest	= 4,800
		$12,800

3. Change life to 8 years with the same absolute amount of interest as for previous 5 years life:

Present Value:	Principal-$10,000 x .40388	= $ 4,039
	Interest-$750 x 4.96764	= 3,726
		$ 7,765
Absolute amount of cash:	Principal	= $10,000
	Interest	6,000
		$16,000

A look should be taken at how theory and reality relate to the standard-setting process.

basically continued existing practice. Instead of recognition of losses in the value of receivables, increased disclosure was deemed sufficient.

Statement No. 15 applied only to troubled debt restructurings defined as occurring when ". . .the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor it would not otherwise consider." In the case where the debt is settled, gains and losses are recognized by each party based on the fair value of assets exchanged in relation to the recorded value of the debt.

When debt is continued with a modification in terms, treatment depends upon the amount of the total future cash flows. If this total is less than the carrying amount of the debt (a rare situation), gains and losses are recognized. If, however, the new terms result in total future cash flows greater than the carrying amount of the debt, no gain or loss is recognized by either party. Instead, a new effective interest rate is used to recognize a smaller amount of interest revenue or expense over the remaining life of the debt. No distinction was made as to the type of change. Accounting for reductions in face amount was made consistent with other modifications.

Theoretical Inconsistencies

As highlighted previously, much of the dissent of the banking industry focused on their displeasure with current value accounting. Letters cited a desire to let the FASB complete its conceptual framework project instead of taking a "piecemeal" approach with regard to one industry. The intervening seven years have produced several Statements of Financial Accounting Concepts in the framework project. Analysis of *Statement No. 15* in conjunction with these conceptual pronouncements indicates that the debt restructuring statement exhibits serious deficiencies.

The FASB has continually emphasized that conceptual framework pronouncements are suggestive rather than definitive. It has also disclaimed attempts to apply concepts retroactively to prior statements. But given the obvious concurrent work on concepts and actual statements, it does not seem to be asking too much to expect some consistency in standards. *Statement No. 15* presents an unfortunate example where the FASB appears to have thrown out the theory when the political pressures intervened.

This is not to say that industry pressure always produces unwanted consequences. Economic aftereffects of standards are at least as important as internal theoretical consistency, and industry is frequently most cognizant of what standards will do to their operations and the economy in which they interact. But it does warrant a look at how theory and reality relate to the standard-setting process.

Objectives of Financial Reporting. As part of the conceptual framework, the FASB defines the purposes of financial reporting. The three primary objectives are to provide (1) information useful in investment and credit decisions, (2) information useful in assessing cash flow prospects, and (3) information about enterprise resources, claims to those resources and changes in them. For industries whose resources consist materially of monetary assets and liabilities, the course prescribed by *Statement No. 15* appears to run counter to each of these objectives.

Consider the example in Exhibit 1. A firm holding the $10,000 receivable would suffer an economic loss under any of the three modifications. Under *Statement No. 15*, there would be no loss on the income statement and no indication on the balance sheet that assets were less valuable than before the restructuring. The negative effects on future cash flows are obscured; the changes in the value of the enterprises resources are ignored; and potential debt or equity investors are forced to rely on additional disclosures to analyze what is really happening in the firm.

And what of the additional disclosures? The Statement prescribes that creditors disclose the income that would have been recorded in the period ignoring restructure in comparison to that which was recorded. Commitments to lend additional funds are also disclosed. It does not require disclosure of information that would enable investors to assess future cash flows. In addition, the FASB specifically allows firms to choose their own forms of disclosure. The disclosure requirements can be met by discussion of reduced earnings potential of entire portfolios of receivables, grouped into major categories, without separate mention of troubled restructured receivables. Thus it is generally impossible for the user of financial statements to determine the effects of debt restructurings on the firm.

What is a transaction? The traditional accounting model records assets at their historical cost. Because this cost is not changed to reflect changes in value, the model has been subject to criticism that cost loses relevance as it diverges from value, and that value should replace cost in a new accounting model. Bankers objected to being among the first to be subject to new current value techniques.

Transactions are not prerequisites for accrual-based accounting systems, but existence of economic substance and change are.

But parties on both sides of the current value/historical cost debate agree that the two are identical at the moment of the arms' length transaction between parties. The primary flaw in the outcry against using present value to measure the value of the restructured receivable is the misunderstanding of this fact. Present value is merely the technique that is used to measure value, and at the point of the transaction it is the technique used to measure cost as well. The $10,000 recorded value of the original transaction is historical cost. It is a combination of the present value of the principal to be received in five years and the present value of the stream of interest cash flows over five years.

The key to what the receivable should reflect concerns not whether or not present value techniques should be used but whether or not a transaction has occurred which triggers determination of a new "cost" to the firm. The FASB rationale was that a transaction of substance has not occurred. Without a transaction, no new carrying value (and consequently no recognized loss) is required.

Not only is this argument itself without merit, but it is also one which appears to be trotted out when rationale is needed for selected pronouncements and completely ignored for others. Transactions are not prerequisites for accrual-based accounting systems, but existence of economic substance and change are. Wearing out of fixed assets is of sufficient economic significance to record periodic depreciation. Gains and losses on foreign currency commitments are accrued for reporting because exchange rate changes indicate economic gain or loss. Leases which are sales in disguise must be capitalized and depreciated, regardless of the lack of "ownership." Even more closely tied to the debt restructuring situation are accruals of losses for warranties and contingent liabilities. In each case the present period is assessed for losses expected to physically occur in the future. This accounting is justified on the basis that the future losses will result from events that have already occurred, and in spite of the necessity to estimate.

Troubled debt restructurings are no different in concept. Future losses will occur because of new loan terms, transacted in the present and precisely measurable. The old recorded value incorporated expectations of future income. A transaction has occurred and new expectations of reduced future income should define a new historical cost.

Public Pressure

Restructuring of debt joined that group of controversial issues where special interest groups influence decisions to ignore economic substance with the argument of "no transaction." Most prominent among these is non-accounting for pension liabilities. Public outcry against FASB proposals to recognize unfunded pensions as liabilities may very well result in theory again taking a back seat.

The FASB is in an unenviable position, fighting for its existence between two formidable parties. On one hand, business demands favorable accounting standards; on the other the SEC expects standards to keep business in line. Funding comes from the business community; the right to exist from the SEC. It is little wonder that pronouncements frequently reflect desperate attempts to keep each at bay. Unfortunately, evidence increasingly suggests that the FASB will not stand up to strong business lobbying. Complaints of income fluctuations by multinational businesses led to rescission of *Statement No. 8* on foreign currency translation. Accounting for changing prices was only addressed after the SEC stepped in with its own requirements. And the FASB was never able to get past business' objections to its proposals for dealing with the controversial sales/leasebacks of investment tax credit assets allowed by the first Reagan tax bill. On that subject no definitive pronouncement was ever issued.

Business demands favorable accounting standards; the SEC expects standards to keep business in line.

Economic Reality

Theoretical inconsistency and bowing to industry pressure have both been defended by arguments invoking potential effects of accounting rules on "the greater good." *Statement No. 8* was said to inspire inefficient foreign currency management practices and was even accused of contributing to the decline of the dollar. The same type of arguments were advanced by the banking lobbying efforts for *Statement No. 15.* Bankers claimed that recognizing losses would stifle the economy by inhibiting loans to needy parties and by drying up capital reserves. It is true that, in the face of severe macroeconomic effects, an insistence on theoretical consistency appears trivial. To analyze this argument, it is necessary to consider what economic effects *Statement No. 15* has contributed to in its brief history.

The accounting rules which allowed banks to postpone recognizing economic losses have had more negative than positive economic consequences.

The major effect of the statement is that it allows creditors to avoid reducing their income, with the concurrent effects on capital, as long as new terms guarantee that future cash flows equal or exceed the debt's carrying amount. If the debt were instead settled for whatever the creditor could get, a loss would ensue. This is the real inefficiency of the statement: creditors are lured into the more pleasing route of income statement restructuring, despite the real possibility that they would be economically better off to settle immediately.

One has to look at the events in the international lending community to understand the negative economic reality that has been fueled by an accounting anomaly. Since 1973, debt of the 16 largest third world debtors has increased by over $480 billion reaching $520 billion by early 1985. As the dollar strengthened with high interest rates, many of these countries began experiencing disruptions of debt servicing in the early 1980's. About two-thirds of this debt is in trouble. In

1981, $2.6 billion debt was rescheduled; in 1985 it may reach or exceed $100 billion.

As long as the debtors can continue borrowing enough to pay interest on old loans, the merry-go-round continues. When debtors begin faltering, the recycling slows. Some worried creditors, usually the least exposed, stop throwing good money after bad. Others are too involved to cut their losses. If you owe the bank $1000 and cannot pay, it is your problem. If you owe the banks $300 billion and cannot pay, the banks are in trouble. Consider Citibank, for example. As the largest U.S. bank, it has capital of $5.5 billion. Citibank's Brazilian loans alone amount to $4.4 billion. Manufacturers Hanover has $3.7 billion, 112 percent of its net worth, tied up in loans to Brazil and Argentina. Chase Manhattan also has $3.6 billion, or 92 percent of its net worth, in loans to the same two countries. The nine largest U.S. banks together have $28 billion in capital, but $64 billion in loans outstanding to troubled economies.[1] One year of no interest or principal payments from Latin America would eliminate all profits and most capital of these U.S. banks. If Brazil, Argentina, and Mexico decided to join forces and repudiate their debts, the nine largest U.S. banks would be wiped out.

Of course this will not happen. Governments, both of debt troubled countries and strong banking countries, cannot allow the massive collapse of the international monetary system this situation portends. Efforts are being made by the International Monetary Fund, groups of debtor countries, and others to forestall each confrontation between bank and debtor country. The banks may come out in the end solely because they are too vital to let go under.

Whatever the ultimate resolution of the crisis, it is obvious that the accounting rules which allowed banks to postpone recognizing economic losses have had more negative than positive economic consequences. What would have happened given the necessity to write down restructured loans is impossible to reconstruct. But in retrospect it is easy to believe that the loan merry-go-round would have slowed more gradually, with time for the world economy to readjust, than face the present fear of total collapse.

Conclusion

Standard setting for financial reporting is a complex process affected concurrently by the need to serve numerous masters, maintain theoretical consistency, and accommodate the realities of the world economic structure. Ideally, financial reporting should measure and report behavior, not become the object of behavior. The accounting principle should not influence the economic decision, but merely report it. The troubled debt pronouncement is an unfortunate example where all the negative factors came into place at one time. The primary arguments against recognizing losses on restructuring were theoretical consistency and the potential effects on the economy. The resulting statement is a model for inconsistency, and has probably exacerbated the largest financial crisis in history. The FASB's pronouncement provides heavy fuel for those parties who scorn the ability of business and the accounting profession to regulate themselves.Ω

NOTE

[1]Von Hoffman, Nicholas, *The New Republic*, October 14, 1985, pp. 21-22.

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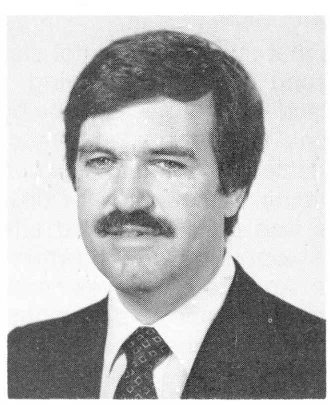

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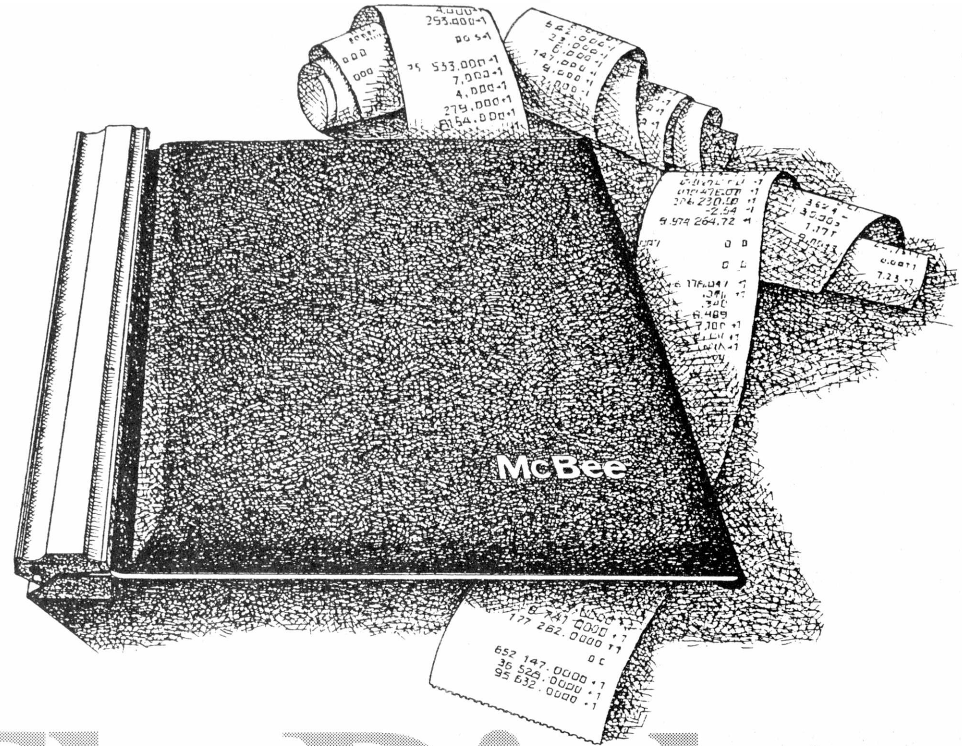
Home Office Deduction from page 13

by looking to the nature of the business activities, the attributes of the space in which the business activities can be carried out and the necessity of using a home office to carry out such activities.

While the Weissman decision is relatively narrow in scope, many university professors may be able to apply their factual situations thereto in substantiating a home office deduction.Ω

NOTES

[1]Weissman v. Commissioner, TC Memo 1983-724, rev'd, 55 AFTR 2d 85-539.
[2]S. Rep. No. 94-938, 94th Cong., 2d Sess. 148 (1976).
[3]Weightman v. Commissioner, TC Memo 1981-301.
[4]S. Rep. No. 94-938, 94th Cong., 2d Sess. 148-149 (1976).
[5]Proposed Regulation §1.280A-2(b)(3).
[6]Bodzin v. Commissioner, 60 TC 820 (1973), rev'd, 509 F.2d 679 (CA-4), 35 AFTR 2d 75-618.
[7]Weissman, at 541.
[8]Ibid., at 540-541.
[9]Drucker v. Commissioner, 79 TC 605, rev'd, 715 F.2d 67 (CA-2), 52 AFTR2d 83-5804.
[10]Weissman, at 542.
[11]Ibid., at 542-543.
[12]§280F(d)(3)(A).
[13]Curphey v. Commissioner, 73 TC 766.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Management Presentation

Strategies for Structuring and Delivering Ideas

By Michael C. Giallourakis

As professional accountants you will from time to time be called upon to present a proposal, a budget, or a program orally to either an internal audience or to an external audience who has the power to accept or to reject the substance of the presentation. Your success or failure depends on your ability to effectively inform and persuade the audience to your point of view. Therefore, your presentation must be prepared and delivered with great care because of the high personal and professional stakes involved. The purpose of this article is to provide for the professional accountant a pragmatic and structured system for preparing and delivering a management presentation. The first step in preparing your presentation is to understand the nature of the presentational objective.

Presentational Objective

In developing an effective strategy for the presentation, it is important to formulate an objective for the presentation because the objective will focus your presentation. An example of a useful objective would be: What specific results do I expect from this presentation? Once you have decided on the objective, you can then begin developing an effective and appropriate message to obtain your objective. Another reason for requiring the objective is that of measuring results. By having a clear objective, you will be able to judge whether or not your presentation was effective. In other words, the objective should make it easy for you to measure success or failure. Once you have identified your objective, the next step in preparing for your presentation is to analyze and adapt to your audience.

The Art of Audience Analysis

Audience analysis is a set of informational inputs concerning the nature of your audience which plays an important part in determining the best communicative strategy for accomplishing your presentation objective. Its purpose is "to discover audience needs, attitudes, values, and predispositions" so that your presentation will be seen as relevant to these. [Timm, 1980, p. 223] Another function of audience analysis is "to determine how much knowledge your audience knows about the subject or would like to know." [1980, p. 223] The objective of audience analysis for the presenter is to obtain a realistic assessment of the audience since it is impossible to know everything about the audience. Once you have constructed an image of your audience needs and attitudes you then can tailor your presentation to suit the audience's needs and attitudes. The Audience Analysis Audit [Morrisey, 1968, pp. 20-21] in Figure 1 suggests some questions that you might ask yourself as you prepare your presentation.

A pragmatic and structured system for presenting proposals will aid the accountant in successfully informing and persuading others.

Now that you have completed your objective for the presentation and you have analyzed your audience, there is the third step to prepare for and that is the construction of a preliminary plan.

The Preliminary Plan

The development of the preliminary plan is your blueprint which will guide your audience through your presentation to the desired outcome. The preliminary plan, therefore, can help you with the placement of main ideas and with the supporting material necessary to avoid frustration and confusion, and to make sense out of a whole assortment of ideas, information, and objectives [Applbaum and ANATOL, 1982]. In a sense it will help you decide what kind of material you will need and how much you will need to accomplish your objective.

Main Ideas. If you are to be successful in your presentation you will, as the presenter, have to spell out the concepts or main ideas which you wish the audience to understand, accept, and follow through on. How do you do that? By stating your main ideas (one but no more than five) in the form of conclusions you want the audience to reach [Timm, 1980]. That is the objective of the preliminary plan.

Main Ideas-Support. Now that you have your one or five ideas started, it is necessary to determine what evidence is necessary to help the audience not only understand what you are presenting but to have them follow-through on a desired action. Each presenter has his own style for organizing material. The presenter should select an organizational format which will best fulfill his/her presentation objective. With that in mind, Figure 2 provides a guideline for developing the preliminary plan and [Morrisey, 1968, pp. 24-25] Figure 3 presents a sample of a persuasive presentation. [Morrisey, 1968, p. 32]

Selecting Supporting Materials. As you construct the presentation you begin seeking and identifying supporting material which will not only relate to the main idea(s) but which will clarify, amplify, and make the main idea(s) interesting.

The types of supporting materials generally used to develop the presentation will normally depend on the objective of your presentation. Generally, supporting materials are classified as:

- Statistics
- Examples
- Testimony
- Analogies
- Visual Aids

These types are not meant to be all inclusive. Any material which will help you to explain or to describe your main idea(s) should be used.

To help you determine whether or not you should use a given material as support [Applbaum and ANATOL, 1982, p. 152], the following checklist is provided:

- Does the material meet the audience's need?
- Does the material relate to the presentation objective?
- Does the material support the presentation's main points?
- Can the audience understand the material?
- Is the material timely?
- Is this the best available material?

Using supporting material effectively is a matter of blending presentation objective with outcome, so if the answer to any of the above questions is no, you must begin seeking other types of material for your presentation.

Organizing your Materials. Now that you have determined your presentational objective, analyzed the audience, developed a preliminary plan, and selected the supported material, you must now organize your presentation so that the audience may easily follow your development of the subject.

Most presentational messages are arranged into three basic organizational structures; the introduction, the body, and the conclusion.

FIGURE 1
Audience Analysis Audit
(Fill in the blanks or circle the terms most descriptive)

1. Identify the objectives in presenting your briefing to THIS audience. What do you want to happen as a result of it?

____

____

2. Specific analysis of members of this audience—

a. Their knowledge of the subject:
High Level General Limited None Unknown

b. Their opinions about the subject and/or the speaker or organization represented:
Very favorable Favorable Neutral
Slightly hostile Very hostile

c. Their reasons for attending this briefing:

____

d. Advantages and disadvantages of briefing results to them as individuals:

Advantages ______________________________

Disadvantages ______________________________

3. General analysis of members of this audience—

a. Their occupational relationships to speaker or his organization:
Customer Top Management Immediate Management
Co-workers Subordinates Other Management
Other workers Public

b. Length of relationship with company as customer or employee:
New Less than two years More than two years
Unknown

c. Their vocabulary understanding level:
Technical Nontechnical Generally high
Generally low Unknown

d. Open-mindedness (willingness to accept ideas to be presented):
Eager Open Neutral
Slightly resistant Strongly resistant

4. Information and techniques most likely to gain the attention of this audience:
Highly technical information Statistical comparisons
Cost figures Anecdotes Demonstrations Other

5. Information or techniques likely to get negative reactions from this audience:

____

The Introduction

The development of the introduction in any presentation is important because it sets the stage for the audience to decide whether or not to accept, reject or to even listen to the presentation. The development of the introduction should be short and interesting. It should include "what" the presentation is about and a brief statement of "why" the presentation is important. In other words the introduction should be developed in such a manner as to obtain the attention of the audience and to prepare them for the presentation.

FIGURE 2
Guidelines for Preparing a Preliminary Plan

1. Identify specific objectives for the briefing, keeping in mind the following criteria:
   a. They should answer the question, "Why am I giving this briefing?"
   b. They should state the results desired from the briefing, in effect, completing the sentence, "I want the following things to happen as a result of this briefing: . . . ."
   c. They should be designed to accomplish whatever hidden objectives you have for the briefing.

Note: If the body of knowledge to be presented must be identified in the objectives, use a sentence such as "I want to tell about . . . so that . . . will take place."

2. Identify the specific audience for whom you are designing this briefing and state in a one- or two-sentence summary pertinent information about their knowledge, attitudes, and so forth.
3. State the MAIN IDEAS OR CONCEPTS that the audience MUST get if the objectives of the briefing are to be met.
   These should:
   a. Be in conclusion form and preferably in complete sentences.
   b. Definitely lead to the accomplishment of the specific objectives.
   c. Be interesting in themselves or capable of being made so.
   d. Be few in number, usually no more than five.
4. Identify under each main idea the types of factual information necessary so that this audience can understand these ideas. Avoid excessive detail.

This plan should be used as a guide:

1. For the briefer in selecting materials, keeping ideas channeled, and determining emphasis points.
2. For support personnel who may provide the backup data, prepare charts and other aids, and assist in the briefing itself.

The Body

Now that you have the attention of the audience, the stage is set for the body of your presentation. The body presents your main points in a logical sequence and helps to clarify points of view. In addition, it summarizes your arguments so that the audience will recall what was being presented.

Organizing Your Main Points. You have now arrived at the most important part of your presentation. The question you need to ask yourself now is "How can I arrange my presentation material to best achieve my objective?"

What types of arrangement patterns are available to you which can be useful in providing a clear, useful, and meaningful relationship among your main points? Described below are several types of patterns of arrangement; they all help to structure the presentation's main points.

Problem Solving Pattern. If you are advocating a solution to a problem, you will want to use this type of pattern not only for its ability to logically lead an audience through the problem to a suitable solution but also to see how your audience finds the solution to resolve the problem.

Cause-effect Pattern. Using this type of pattern the presenter can arrange materials around the causal relationship and its effects. This type of pattern has two main elements. It has a descriptor of the factors which is the cause and it has a predictor of the effects. A presenter may want to use this type of pattern when emphasizing the advantage or disadvantage of an idea.

Chronological Pattern. This type of pattern is used to organize the main points according to a logical time progression. For example, if you are invited to present the firm's history, you would use this pattern.

Topical Pattern. When your points in the presentation involve separate development to arrive at the whole topic, the topical pattern serves to unify them. For example, you might want to discuss a financial report by breaking the report into various units such as assets and liabilities, credits and debits, and so on.

In this section, you have been given a brief description of four organizing patterns for your main points. Which organizing pattern will accomplish your goal? That depends on which one will clarify the points best and which will focus on your presentation objective.

Preparing Your Conclusion

Most presentations need an ending. The conclusion provides a final message which should reinforce the presentational message and the purpose of the presenter. It should not contain any ideas or information.

At the Podium-Delivery

Now that all the planning and development of the presentation is completed, it is time to present yourself before the audience and deliver your presentation. Most of us understand and recognize the importance of delivery yet quite often feel fearful or uncomfortable standing there before an audience. Such feelings are normal. It becomes abnormal when you let those feelings of anxiety force you to become dysfunctional.

Since the effectiveness of your presentation depends upon your ability to deliver your message, it is important to understand the phenomenon known as "stage fright" or "speech tension" which may have an effect on the outcome of your presentation. The stage fright concept may be defined "as a fear of the situation." [Baker, 1981, p. 379]. In this section, information will be provided concerning the nature of stage fright, its causes, and suggestions for controlling it.

The Nature of Stage Fright

It is important to stress here that each person, even the most polished presenter, has some amount of discomfort and anxiety before appearing in a presentational situation in which there is some risk. The point that should be stressed is that the degree of intensity due to the presentational situation will vary from individual to individual. Sometimes the intensity is so great that it prevents an individual from presenting the message. To ignore a presenter's anxiety is to ignore a serious issue that most presenters need to understand and cope with. Therefore, the best way to understand these feelings of anxiety is to approach the two underlying causes.

Physiological Reactions. The physiological reactions such as sweaty palms, palpatations of the heart, fidgeting, trembling and other nonverbal behaviors usually do not make it impossible for the presenter to present his message before an audience. In fact, many of these symptoms are a function of inward stress and are normal. [MaKay and Sawyer, 1973, p. 36] Because the adrenalin has entered our body system and our defense shields are activated as we approach an uncertain situation, these symptoms will only become dysfunctional when they are seriously exaggerated, or the presenter becomes preoccupied with them. Personally, these symptoms can provide the presenter with a little extra stimulation which will make the presenter energetic.

Psychological Reactions. The worst problems that a presenter faces are the psychological ones [Andrews, 1979, p. 193]. For example, when an individual was told by his secretary that "he must stand at a lectern at the next Board of Directors meeting to give his report, he announced that he would resign first before he would put himself through such an ordeal." [Tacey, 1983, p. 124] Another example is when a "speaker stalled, I took his arm and said, 'Let's find out who is scaring you. . . .' As I named each person, including myself, he kept saying no. At last he confessed that no individual was guilty." [1983, p. 125] These anxiety behaviors can be traced to a lack of self-confidence in oneself. Why this lack of self-confidence? Perhaps the presenter feels inadequate in preparing for the presentation, or the presenter somehow feels unworthy to communicate the message, or the presenter allows the communication situation to intimidate him/her. Whatever the reasons are for the stage fright, presenters can minimize and control its effects.

FIGURE 3
Sample of a Persuasive Presentation

Topic: Need for Increased Training in the Company

Objectives:

1. To create an awareness of the need for increased training.
2. To gain management approval and support for increased training so they will act to:

   a. Authorize necessary funds,
   b. Authorize time for training, and
   c. Give verbal and written support to training efforts.

Audience:

Members of top management plus other management personnel at director level or higher. Most will have a general knowledge of the subject; a few will be favorably inclined, but most will be neutral, skeptical, or slightly hostile.

Main ideas the audience MUST get:

1. Increased training is essential if we are to survive in the industry.
2. Money invested in training now (charged to overhead or taken from profit) will be returned manyfold in the future.
3. Time spent in training now (taken from urgent current work) will result in a much more profitable use of time in the future.

Factual supporting information:

Idea 1

a. New technology requirements.
b. Training experience in other similar companies.
c. Potential application of new management concepts.

Idea 2

a. Recent training progress in the company.
b. Comparative cost of operation figures (before and after).
c. Personnel training versus replacement costs.

Idea 3

a. Comparative (before and after) time-investment ratios.
b. Intangible time benefits, for example, increased confidence and effectivity of personnel resulting in more productive use of time.

Causes of Stage Fright

The causes of stage fright are not yet fully known; however, communication research has been able to shed some light into this extremely disruptive communication problem. According to Baird, stage fright stems from three main sources: the audience, the message, and you, the presenter. [1981, p. 80] Let us briefly examine each category and note specific causes within each.

The Audience

A. Evaluative Apprehension. Communication researchers have confirmed that this is the most potent cause of our anxiety. Why? Because we are uncertain of what the evaluation will be. The presenters somehow feel that the performance will be judged inadequate, thus damaging their esteem. For the presenters, this is a threatening situation because one's self is being exposed to the judgment of others.

B. Fate Control. These are situations where you must make presentations before your peers. Such audiences

FIGURE 4
PERSONAL REPORT OF COMMUNICATION APPREHENSION

This instrument is composed of twenty-five statements concerning feelings about communicating with other people. Please indicate the degree to which each statement applies to you by marking whether you (1) Strongly Agree, (2) Agree, (3) Are Undecided, (4) Disagree, or (5) Strongly Disagree with each statement. There are no right or wrong answers. Work quickly, just record your first impressions.

	SA	A	UN	D	SD
1. While participating in a conversation with a new acquaintance I feel very nervous.	1	2	3	4	5
2. I have no fear of facing an audience.	1	2	3	4	5
3. I talk less because I'm shy.	1	2	3	4	5
4. I look forward to expressing my opinions at meetings.	1	2	3	4	5
5. I am afraid to express myself in a group.	1	2	3	4	5
6. I look forward to an opportunity to speak in public.	1	2	3	4	5
7. I find the prospect of speaking mildly pleasant.	1	2	3	4	5
8. When communicating, my posture feels strained and unnatural.	1	2	3	4	5
9. I am tense and nervous while participating in group discussion.	1	2	3	4	5
10. Although I talk fluently with friends I am at loss for words on the platform.	1	2	3	4	5
11. I have no fear about expressing myself in a group.	1	2	3	4	5
12. My hands tremble when I try to handle objects on the platform.	1	2	3	4	5
13. I always avoid speaking in public if possible.	1	2	3	4	5
14. I feel that I am more fluent when talking to people than most other people are.	1	2	3	4	5
15. I am fearful and tense all the while I am speaking before a group of people.	1	2	3	4	5
16. My thoughts become confused and jumbled when I speak before an audience.	1	2	3	4	5
17. I like to get involved in group discussions.	1	2	3	4	5
18. Although I am nervous just before getting up, I soon forget my fears and enjoy the experience.	1	2	3	4	5
19. Conversing with people who hold positions of authority causes me to be fearful and tense.	1	2	3	4	5
20. I dislike to use my body and voice expressively.	1	2	3	4	5
21. I feel relaxed and comfortable while speaking.	1	2	3	4	5
22. I feel self-conscious when I am called upon to answer a question or give an opinion in class.	1	2	3	4	5
23. I face the prospect of making a speech with complete confidence.	1	2	3	4	5
24. I'm afraid to speak up in conversations.	1	2	3	4	5
25. I would enjoy presenting a speech on a local television show.	1	2	3	4	5

Scoring the PRCA

1. Add up your scores for items 1,3,5,8,9,10,12,13,15,16,19,20,22, and 24.
2. Add up your scores for items 2,4,6,7,11,14,17,18,21,23, and 25.
3. Complete the following formula:

PRCA score = 84 − (total from step 1) + (total from step 2)

Interpretation of score:

60 + = Some communication apprehension
88 + = High communication apprehension

Source: McCroskey, James C.

can be extremely frightening thereby creating high levels of fear because of the control they exercise over your fate, such as being promoted.

C. Status. Sometimes when the audience consists of individuals with status higher than yours, they tend to produce anxiety, while audiences of equal or lower status tend to produce lesser anxiety reactions.

The Message

A. Complexity. Sometimes material difficult to comprehend causes anxiety for the presenter who must deliver it.

B. Interestingness. Sometimes the presenter worries about how to present uninteresting information in an interesting manner. This causes anxiety.

C. Significance. Sometimes the presenter worries about how an issue will be perceived by an audience. If the audience is favorable towards the issue, there is no anxiety. However, if the audience perceives the issue as trivial, our anxieties begin to grow.

You The Presenter

A. Lack of Experience. If this is your first experience at presenting then you have some anxieties. However, the more you present, the less anxieties you will have.

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B. Self-Expectations. Are you realistic about the standard of achievement that you have set for yourself. Sometimes you may demand too much of yourself thereby overreacting. This tends to provoke anxieties.

C. Fear Behavior. Everything is going well in the presentation when all of a sudden you notice that your hand is shaking. You begin to think that you must be scared. All of a sudden, you have high anxieties. What you have done is—you scared yourself.

Controlling Your Stage Fright

As you can see, there are many factors which contribute to your feelings of stage fright. Your goal, therefore, is not to eliminate all of your fears about presenting, but to control the fear of presenting. You want to manage it. The following suggestions should help manage stage fright.

- Be well organized.
- Have a positive attitude.
- Make sure you practice.
- Obtain experience in presenting ideas.
- Never memorize.

Never under any circumstances destroy your confidence before a presentation with negative thoughts. Instead, build your confidence rather than tear it down.

If you are curious about your level of communication apprehension, fill out the questionnaire [McCroskey, 1970] in Figure 4. Should the questionnaire suggest that you may have high communication apprehension, it is suggested that you seek help to overcome this disruptive communication problem. The decision you make to seek help may be the most important decision you ever make.

Conclusion

To achieve effectiveness as a presenter you must understand the nature of the presentational objective, be able to identify your audience's needs, develop a preliminary plan, and select the supported material. Once you have achieved the above you now must arrange your presentational message into the three basic organizational structures: the introduction, the body, and the conclusion.

Another problem which prevents you from being effective in presenting is stage fright. To overcome this disruptive communication problem, the presenter must understand its nature and its causes. Stage fright can be controlled by focusing on being positive, by being well organized, and by practicing.Ω

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SOP 85-1: Implications for Health Care Organizations

New Financial Reporting Requirements

By Walter A. Robbins

On January 1, 1985, the Subcommittee on Health Care Matters of the American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) 85-1 entitled "Financial Reporting by Not-for-Profit Health Care Entities for Tax-Exempt Debt and Certain Funds Whose Use Is Limited." The SOP provides guidance for nonprofit health care organizations in three specific areas: (1) reporting long-term debt issued through a financing authority, (2) classifying funds whose use is limited as either general or restricted, and (3) reporting related investment income and interest expense in the financial statements. This article discusses the content of the Statement and presents a flow chart of the prescribed accounting and reporting procedures.

Classifying Tax-Exempt Debt Issued by Financing Authorities and Assets with Limited Use

Health care organizations prefer issuing tax-exempt debt because they can obtain a higher ratio of project financing, longer maturity periods, and interest cost is lower than with taxable debt. Unfortunately, the majority of health care organizations are legally precluded from issuing tax exempt debt directly. In an effort to combat this problem, health care organizations have begun establishing separate entities called "financing authorities." These entities are authorized to issue tax-exempt bonds or other obligations for the benefit of the parent organization. After issuance, the authority loans the necessary funds to the health care organization. This approach allows the health care organization to comply with legal restrictions while still enjoying the benefits associated with tax-exempt debt.

When a financing authority issues tax-exempt bonds or similar debt instruments and uses the proceeds for the benefit of a health care organization, the question arises as to how the proceeds and the debt obligation should be reported. The Subcommittee on Health Care Matters concludes that:

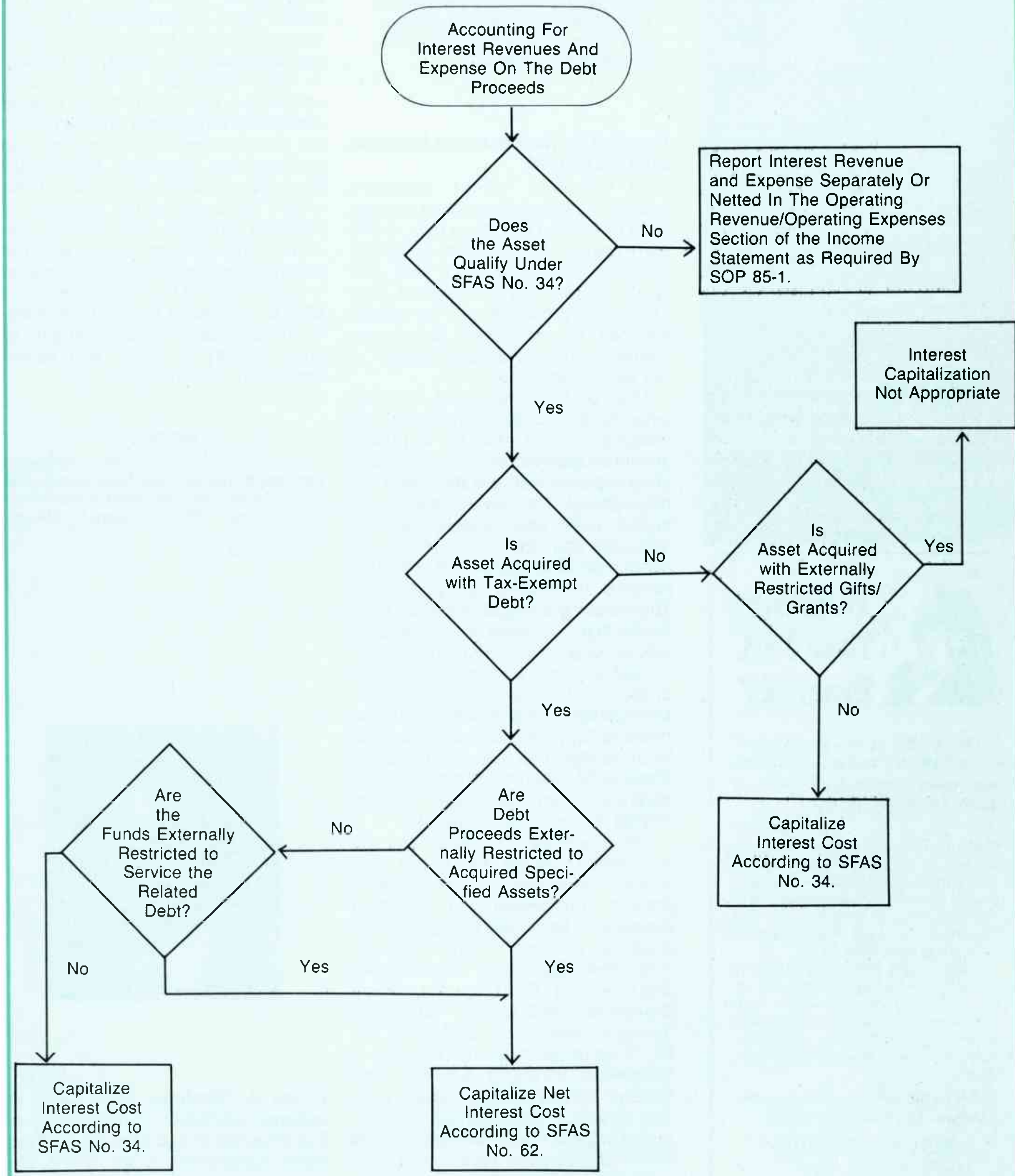
> Health care organizations have begun establishing separate entities which legally may issue tax-exempt bonds.

1. Only assets restricted by a donor or by a grantor should be reported in the donor-restricted funds section of the balance sheet. Other assets should be reported in the general funds section of the balance sheet.
2. Not-for-profit health care entities should report as liabilities in the general funds section of the balance sheet, obligations issued for their benefit and for repayment of which they are responsible when the obligations are issued.[1]

When resources are contributed to the health care organization with donor restrictions, GAAP requires that they be reported as assets in the restricted fund section of the balance sheet with an offsetting increase in the Fund Balance. No obligation is reported. The health care organization must then earn the resources by complying with any legal restrictions. Once this earnings process takes place, no repayment is necessary by the health care organization. Since resources received through debt issuance must be repaid, no earnings process occurs. Moreover, unrestricted resources are generally used to retire the debt obligation. The Subcommittee's position was taken primarily because of the requirement that debt obligations must be repaid, whether or not the debt covenant contains any spending restrictions.

The subcommittee also examined the question of whether funds whose use is limited under the terms of a trust agreement, third-party reimbursement arrangement, or other similar arrangement should be classified on the health care organization's balance sheet as unrestricted or as restricted funds. It was observed that such agreements are normal and recurring business activities that are necessary for carrying out the organization's objectives, and are entered into at the discretion of the governing board. Moreover, such agreements are related to the general and unrestricted business operations. The Subcommittee concluded that:

EXHIBIT 1
A Flow-Chart Summary of SOP 85-1, SFAS 34 and SFAS 62



> Assets whose use is limited in substance under terms of debt indentures, trust agreements, third-party reimbursement arrangements, or other similar arrangements should be reported in the general funds section of the balance sheet as assets whose use is limited.[2]

Reporting Investment Income and Expense

As indicated earlier, hospitals finance most long-term asset acquisitions by issuing long-term debt. In the early stages of acquisition, especially if assets are constructed, debt proceeds are generally not essential. Consequently, proceeds will be initially invested. The objective is to generate interest income to defray a portion of the borrowing costs.

The SOP states that interest expense and investment income on borrowed funds held by a trustee should be reported separately as operating expense and operating revenue, respectively. The health care organization may alternatively net the amounts and report the results as either operating expense or operating revenue, whichever is appropriate. The offsetting amounts, however, must be disclosed parenthetically. The SOP also requires that investment income related to funds whose use is limited under third-party reimbursement arrangements (for example, funded depreciation) and general funds held by a trustee that are not borrowed funds to be reported as nonoperating revenue. If material, each amount should be reported separately.

The health care manager and the accountant should be aware that interest expense and investment income on borrowed funds held by a trustee may be subject to capitalization rules as set forth in the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 34, "Capitalization of Interest Cost," and SFAS No. 62, "Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowing and Certain Gifts and Grants." Although the requirements of these FASB pronouncements are not discussed in this article, Exhibit 1 provides a flowchart summary that integrates the reporting requirements of SOP 85-1, SFAS 34, and SFAS 62.

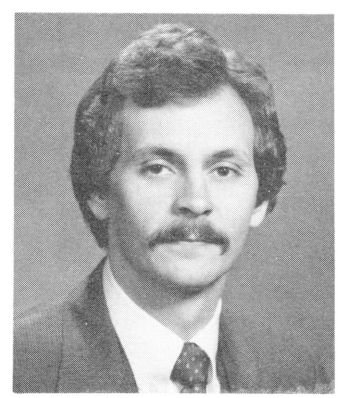
Conclusion

The Accounting Standards Division of the American Institute of Certified Public Accountants has recently examined the accounting and reporting procedures followed by nonprofit health care organizations for tax-exempt debt and certain funds whose use is limited. As a result, on January 1, 1985, Statement of Position 85-1 was issued. The SOP provides needed authoritative guidance and allows for the uniform application of accounting and reporting standards. Health care financial managers and accountants should be aware of the changes so planning can begin for an orderly, systematic transition to comply with the new requirements. Such consideration is essential since the application of the SOP is required in the financial statements for fiscal years beginning on or after January 1, 1985, with earlier application encouraged.Ω

NOTES

[1]Statement of Position 85-1, "Financial Reporting By Not-for-Profit Health Care Entities for Tax-Exempt Debt and Certain Funds Whose Use Is Limited," AICPA, January 1, 1985, pp. 11-12.

[2]Ibid., p. 12.



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Planning and Supervision of an Audit Engagement Under SAS No. 48

New Guidelines Established for a Computer Specialist

By James H. Thompson, Gary L. Waters and C. Wayne Alderman

The first standard of field work requires the work in an audit engagement to be adequately planned and assistants, if any, to be properly supervised. Statement on Auditing Standards No. 22 (SAS No. 22), *Planning and Supervision*, provides guidance for an independent auditor making an examination in accordance with generally accepted auditing standards (GAAS). Specific guidance is provided in the areas of audit program presentation, obtaining knowledge of the entity's business, and dealing with differences of opinion among audit firm personnel. The engagement must be adequately planned and supervised for the auditor to achieve the objectives of the examination. Without proper planning and supervision, the auditor could be confronted with a situation in which there is not an appropriate amount of sufficient competent evidential matter gathered to form the basis for an opinion.

In planning and supervising an audit engagement, an independent auditor may decide to obtain the services of a specialist. Statement on Auditing Standards No. 11 (SAS No. 11), *Using the Work of a Specialist*, is addressed to the auditor who has decided to use a specialist and plans to use the specialist's findings as part of the sufficient competent evidential matter needed to support the audit opinion.

Statement on Auditing Standards No. 48 (SAS No. 48), *The Effects of Computer Processing on the Examination of Financial Statements*, however, points out that the provisions of SAS No. 11 are inapplicable to a computer specialist. SAS No. 11 applies to a specialist who is not a member of the audit team; SAS No. 48 applies to the specialist who is considered an auditor's assistant and is therefore a member of the audit team.

The purpose of this paper is to examine the impact that a computer specialist can have on the planning and supervision of an audit engagement. A brief discussion of the general requirements of SAS No. 22 and SAS No. 11 are presented, and the provisions of SAS No. 48 are summarized and analyzed.

SAS No. 22

SAS No. 22 addresses the planning and supervision necessary to achieve the goals of an audit engagement, that is, to gather the appropriate amount of sufficient competent evidential matter to form the basis for an audit opinion. Detailed guidelines are enumerated in SAS No. 22 for the auditor who is planning and supervising an audit engagement.

The planning phase of the audit engagement involves developing an overall strategy for the expected conduct and scope of the examination. SAS No. 22 states that the planning phase should include steps that allow the auditor to become familiar with the client's business, the industry in which the client operates, and the overall business reputation of the client. Detailed instructions are provided for obtaining this information. In addition, a written audit program is required, and the fact that the planning phase includes scheduling work, assigning personnel, and other administrative matters is emphasized.

SAS No. 22 states that supervision of an audit engagement involves directing the work of assistants and determining whether the objectives of that work were accomplished. Supervision would entail communicating the tasks to be completed and the objectives of the various tasks. Likewise, supervision involves reviewing the completed work of assistants, discussing the review with them, and evaluating their performance. SAS No. 22 emphasizes that supervision would also include dealing with differences of opinion among audit firm personnel.

SAS No. 11

SAS No. 11 discusses the decision to use the work of a specialist, the process of selecting a specialist, and the effect of the specialist's work on the auditor's report. In deciding to obtain the services of a specialist, the auditor has ascertained that some special type of expertise is necessary to gather the sufficient competent evidential matter on which to base an opinion. SAS No. 11 discusses several

The computer specialist is the only specialist who is considered a member of the audit team.

The computer specialist requires the same supervision and review as any assistant.

situations in which the auditor might utilize a specialist.

In selecting a specialist, the auditor should consider the professional qualifications and professional reputation of the specialist. SAS No. 11 states that the auditor should preferably select a specialist who is unrelated to the client. Finally, the auditor is instructed to document the business agreement between the two parties, being careful to emphasize the nature of the work to be completed by the specialist.

If the auditor decides to rely on the work of the specialist and to accept responsibility, then the auditor would issue an unqualified opinion and not mention the work of the specialist. Alternatively, if as a result of the specialist's findings, the auditor cannot issue an unqualified opinion, then the auditor may mention the findings of the specialist in the report.

SAS No. 11 applies to specialists who are not considered members of audit teams. That is, these specialists are not considered assistants of the auditor who has responsibility for planning and supervising the audit engagement.

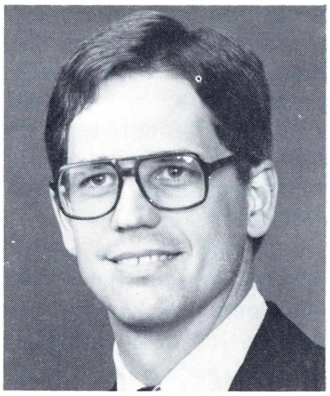
SAS No. 48

SAS No. 48 amends the provisions in SAS No. 22 for planning and supervising an audit engagement for those audit engagements in which the client uses computer processing in preparing the financial statements.

Planning. The effect of computer processing on planning the audit engagement is described in SAS No. 48. The auditor is first instructed to consider the methods used by the client to process accounting information. If the client does use a computer to process accounting information, the auditor is instructed to consider the following matters:

1. The extent to which the computer is used in each significant accounting application.
2. The complexity of the entity's computer operations, including the use of an outside service center.
3. The organizational structure of the computer processing activities.
4. The availability of data. Documents that are used to enter information into the computer for processing, certain computer files, and other evidential matter that may be required by the auditor may exist only for a short period or only in computer-readable form. In some systems, input documents may not exist at all because information is entered directly into the system. An entity's data retention policies may require the auditor to request retention of some information for his review or to perform audit procedures at a time when the information is available. In addition, certain information generated by the computer for management's internal purposes may be useful in performing substantive tests (particularly analytical review procedures).
5. The use of computer-assisted audit techniques to increase the efficiency of performing audit procedures. Using computer-assisted audit techniques may also provide the auditor with an opportunity to apply certain procedures to an entire population of accounts or transactions. In addition, in some accounting systems, it may be difficult or impossible for the auditor to analyze certain data or test specific control procedures without computer assistance.

Supervision. In the area of supervision, SAS No. 48 states that the auditor must decide if an individual with specialized computer skills is needed as a member of the audit team. This individual can be a member of the auditor's firm or an outside specialist. In either situation, SAS No. 48 concludes that the computer specialist is a member of the audit team. Therefore, the auditor is responsible for supervising and evaluating the computer specialist's work and ascertain-



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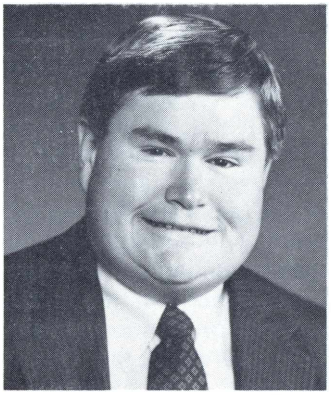

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ing whether the specialist has achieved the assigned objectives. This increased responsibility generally indicates that a higher level of computer skills is required for the supervisory auditor. The computer specialist is the only specialist who is considered an assistant and thus a member of the audit team. The requirements of SAS No. 11 are not applicable to a computer specialist.

Qualifications of the Audit Team. The final implication of SAS No. 48 relates to qualifications of the members of the audit team. Generally accepted auditing standards require an individual to have "adequate technical training and proficiency as an auditor." Likewise Rule 201 of the AICPA Code of Professional Ethics requires that members shall not undertake any engagement that the members or their firm cannot reasonably expect to complete with professional competence. With the increasing amounts of computer processed information and the additional supervisory requirements of SAS No. 48, auditors are expected to be trained and professionally competent in the use of computers. The auditor should possess a basic understanding of computers, computer facility organization, computer data-processing methods, computer processing controls, and computer-assisted audit techniques. A task force of the AICPA has recommended the following knowledge about electronic data processing for a general audit staff member:

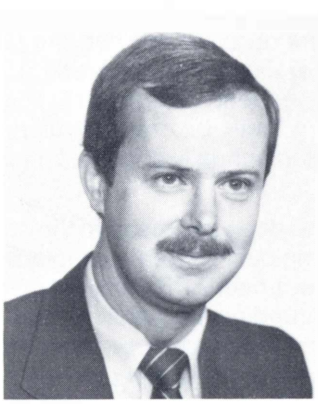
1. A basic knowledge of a computer system—its parts, functions, and capabilities.
2. The ability to design, analyze, and flowchart a system of modest complexity.
3. A general knowledge of a computer language sufficient to program a simple problem.
4. An understanding of the control procedures and needed modification of auditing methods to audit using a computer.[1]

SAS No. 48 implies that the auditor in a supervisory position needs a far more extensive knowledge of computer systems. This individual is responsible for assigning tasks to the computer specialist and evaluating the performance of the computer specialist. This increased supervisory responsibility will require more extensive computer skills for the auditor.

SAS No. 48 implies an increased need for computer skills by all members of the audit staff.

Conclusion

SAS No. 48 gives a subtle hint to public accounting firms that there may be benefits to including a computer specialist on their audit staffs. The Statement points out that a computer audit specialist is considered a member of the audit team. As such, the specialist requires the same supervision and review as any assistant (SAS No. 22). Although these professionals are often referred to as "specialists," they are not specialists in the sense of SAS No. 11. Moreover, their designation as assistants is proper whether such professionals are members of the firm or outside specialists. In addition, SAS No. 48 implies the need for increased computer skills for all members of the audit staff of an accounting firm.Ω



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NOTES

[1]Adapted from *Information for CPA Candidates* (New York: American Institute of Certified Public Accountants, 1975), p. 7.

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Accounting for Pensions

The Complexity Continues

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The FASB has reached the end of its project dealing with accounting standards for defined-benefit pension plans. The Board has been working on this issue since 1974 and completion of the project is a major accomplishment, regardless of the popularity of the final outcome. Since 1980 two discussion memorandums, a Preliminary Views document, two exposure drafts and the final statement have been issued. Each publication has included changes, many of them significant, from previous documents. Between 1980 and the end of 1985 the FASB witnessed 151 presentations over 13 days of public hearings on pensions.[1] The length of time this project required indicates that accounting for pensions is an important and controversial topic.

What Issues Are of Greatest Concern?

The FASB is requiring various changes, most of which emphasize more uniformity of methods and greater disclosure. From the beginning of the project the FASB was committed to a serious revamping of pension accounting from the methods acceptable under APB Opinion No. 8. Statement of Financial Accounting Standards No. 36, "Disclosure of Pension Information," was a first major step because it moved information about the pension plan assets and liabilities into the sponsoring employer's financial statement footnotes. At that time, the FASB clearly stated that it perceived SFAS No. 36 as merely an interim step. Now, the FASB states that some information, notoriously a calculated liability for future benefits to be paid from the plan, should be shown as a liability on the employer's balance sheet. Further, pension cost should be calculated using a uniform method, and the effects of actuarial gains and losses should more realistically affect the employer's calculation of pension expense.

The disclosure, cost calculations and liability presentation, deemed important by the FASB in 1985, are also important to the business community—as indicated by the responses at public hearings. After publication of the Preliminary Views, dissenting opinions were heard which stressed that the FASB was out of touch. Publication of the two exposure drafts instigated dissenting opinions voicing concern that the then-proposed balance sheet liability was "not real," that pension-expense impact on the income statement would be too volatile, and that the increased disclosure would be a hardship, especially for smaller businesses. Perhaps the FASB was trying to make concessions on these issues, in both the exposure draft and final statement as FASB No. 87, "Employer's Accounting for Pensions," requires fewer disclosures for some small companies and a delayed implementation date of fiscal years beginning after 12/15/88 for the recording of any additional liability.

What Are the Changes?

The Liability. The December, 1985 statement of Financial Accounting Standards No. 87, "Employer's Accounting for Pensions," states that a sponsoring employer will show a liability on its balance sheet equal to the amount by which the pension plan's "accumulated benefit obligation" exceeds the fair value of pension plan assets. The accumulated benefit obligation is the actuarial present value of benefits, based on employee service rendered prior to that date. It is calculated using the pension plan's benefit formula and is based on current and past compensation levels. The calculation includes benefits that are both vested and nonvested at the specified date. Fair value of pension assets are calculated using an averaging technique. The credit entry to the balance sheet pension account will be for the amount required to bring the total liability equal to the unfunded accumulated benefit obligation. The total liability will be redetermined and adjusted annually at the balance sheet date.

What does this mean to the sponsoring employer? From a simplistic point of view, under APB 8 if a company has been funding its pension plan in an amount equal to its pension expense it does not show any pension liability on its balance sheet. Under the new FASB statement that will change if assets currently in the plan are not sufficient to meet the calculated amount of future retirement claims of employees. Effectively, if a company wishes to avoid showing this balance sheet liability it has until 1989 to sufficiently fund its pension plan to equal the plan's accumulated benefit obligation.

Criticism has developed for at least two reasons. One, if the fair value of the plan assets exceeds the accumulated benefit obligation an asset is not shown on the sponsoring employer's balance sheet. Two, since the accumulated benefit obligation is based on vested and nonvested benefits a liability is shown that is contingent on future events. Hence, the liability may not be a "true liability," as defined in the Conceptual Framework.

The Cost. Pension cost is to be calculated independently of the pension liability. FASB No. 87 calls primarily for the use of the benefit/years of service approach, also called the projected unit credit method, to calculate pension cost. The benefits/years of service approach is appropriate for most plans because it reflects benefits defined similarly for all years of service. If a particular pension plan provides for benefits based on final pay or on some average of compensation over an entire work life, then pension expense should reflect future compensation levels. This uniformity is a major departure from the range of actuarial methods acceptable for calculating expense under APB 8. As explained below amortization of a related intangible asset and recognition of some component of actuarial gains and losses, if appropriate, are also a part of pension cost.

In some circumstances an "unusual" debit may result from the independent calculations of the pension liability and pension cost, if the credit to the liability is greater than the debit to expense. The debit is shown as an intangible asset to the extent of any unrecognized prior service cost and amortized as a part of pension cost. The remaining portion of the debit is shown as a separate component of the equity section of the employer's balance sheet. Offsetting any unfunded accumulated benefit obligation resulting from unrecognized prior service cost with an intangible asset is conceptually sound. An employer would not grant pension benefits for service prior to a plan's origination or amendment unless some future benefit were expected. Thus, it is reasonable to assume that an asset related to that portion of the pension liability does exist, and will be depleted in the future.

The liability shall equal the amount by which the accumulated obligation exceeds the fair value of the pension plan assets.

Actuarial gains and losses will be amortized when they exceed a defined amount, known as a corridor. The corridor, as defined by FASB No. 87, is 10 percent of the greater of the projected benefit obligation or the fair value of plan assets. The projected benefit obligation differs from the accumulated benefit obligation by inclusion of assumptions about future compensation levels. The usual minimum amortization is to be over the average remaining work years of active employees who are expected to receive benefits under the plan. In certain circumstances this method of recognizing actuarial gains and losses may create unexpected fluctuations in total pension cost.

The Disclosure. The new FASB statement adds considerably to the disclosure which was required under APB Opinion No. 8. New disclosures include: components of net periodic pension costs, ratio of net periodic pension costs to covered payroll, changes in the fair value of plan assets during the period with itemization of certain components, and a reconciliation of the funded status of the plan to the information reported in the sponsoring employer's balance sheet.

FASB No. 87 provides some relief from the disclosure requirements for nonpublic companies sponsoring pension plans with 100 or fewer participants. The disclosures from which these companies are exempted are not extensive. Exempt information includes the breakdown of the components of net periodic pension cost and changes in the fair value of plan assets during the period. Since these companies must perform all the calculations and entries that generally apply, the limited amount of disclosure exemptions may hardly be noticed. In light of the increase in overall disclosure requirements for pensions these small-business concessions can hardly be perceived as aiding the standards overload problem.

Under FASB No. 87 pension cost shall be calculated by the benefit/years of services approach (aka projected unit credit method.)

Conclusion

Pensions has to be a difficult accounting issue; it is impossible to assess it in any other manner. The problem is one of currently accounting for a cash outflow which will occur many years in the future. The cash outflow will be of uncertain amounts, to an uncertain number of people, for uncertain periods of time. Further, appropriate rates for discounting future amounts back to the present are good estimates, at best, and bad guesses, at worst. Controversy surrounds even the nature of the pension liability. Some perceive a pension plan to be a moral obligation of the sponsoring company; others perceive it to be a legal relationship between the pension fund and the participants. Controversy has surrounded accounting for pensions for many years. At the very least, the FASB should be commended for coming to grips with the problem and presenting a workable solution.Ω

NOTES

[1]Donald J. Kirk, "Controversy Apparent at FASB Pension Hearing," *The CPA Letter*, August, 1985, p. 1.

Electronic Data Processing

Negotiating Computer Sales Contracts

Know Your Legal Rights

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By William J. Day

Computer systems are an integral part of American business today. Everything from client billing to automobile design is done by computer. However, the law governing computers and computer systems acquisitions has not developed as quickly as the systems themselves. There is no clear body of law which may be termed "computer law." Instead, one must look to general Contract, Tort, Criminal, Copyright and Patent law for the disposition of issues arising out of the acquisition and utilization of computer systems. This article shall discuss only the contractual aspects of systems acquisitions. "Hacking," stealing computer time, and other pertinent issues cannot be discussed effectively within the boundaries of this article.

There are three main components of a computer system:

1. Hardware—the physical system.
2. Operations software—that which comes initially with the hardware and provides the program by which the system will work.
3. Applications software—programs which can be entered into the system after it has been set up. It is necessary to distinguish between these three components because the acquisition of each may be treated differently under the law.

Uniform Commercial Code, Article 2 is the most generally applied body of law with respect to disputes involving acquisitions of computer systems. The UCC is a codification of general contract law and governs the sale of goods. It is necessary to note at the outset that, by definition, Article 2 of the UCC covers only "sales" of "goods." Therefore, the UCC will not be applicable to acquisitions of software above because:

1. It is unclear whether or not computer software fits the definition of "goods."
2. Many such acquisitions today are leases or licensing agreements rather than "sales."

"Goods" Defined

The easiest case is computer hardware. Hardware is obviously a "good" within the UCC 2-105 definition: "Goods mean all things (including specially manufactured goods) which are moveable at the time of identification to the contract for sale. . . ." A hardware system is both moveable and identifiable. Operations software is more difficult to categorize but courts have held that such software, when sold in conjunction with hardware, is more like goods and can fit within the UCC. Application software is a different story. No one is quite certain how to classify it. Certainly, software is not really a "good" in a physical sense. Software may be more like a service since it provides continuous application of ideas developed by others to the user's business problems. "Goods" are generally accepted to be personal property, but software may be deemed intellectual property and, therefore, may not actually be "goods."

Sale or Lease

The second threshold question to determine whether Article 2 of the UCC will apply to a transaction is whether or not the transaction was a "sale." UCC 2-106 defines a "sale" as "passing title from the seller to the buyer for a price." This is quite straightforward—both buyer and seller know when a "sale" has taken place. However, with computer systems rapidly growing obsolete and being replaced by new, improved models, many business people prefer not to buy a system which could be obsolete in a very short time. Instead, many businesses are leasing computer systems. Clearly, a lease is not covered by Article 2 of the UCC. The same is also true of computer software which is licensed for use rather than sold. The UCC may still be applicable to the transaction if the lease is "phony." That is, the lease is, in substance, a financing arrangement to a contract for sale. Other areas of the law, particularly tax cases dealing with true leases, are worthy of review. It is important, therefore, for the parties to clearly define and understand the transaction.

Contract Negotiations

Though it is unclear whether the UCC will apply in all situations, it is a good starting point to use the UCC when negotiating the acquisition of a computer system. In fact, the parties can agree by a clause in the contract,

"Operations" software when sold in conjunction with hardware has been held by the courts to be "goods."

"Application" software may be more like a service and, therefore, deemed not to be "goods."

that the UCC shall apply to any disputes that arise between them. Careful planning and negotiation should resolve disputes before they arise. The following is a brief discussion of what ought to be included in a computer sale contract. This is by no means exclusive. Whatever the parties to any individual agreement feel is important enough to discuss ought to be discussed and probably should be integrated into the written contract.

When acquiring a computer system the cardinal rule is "NEVER sign the vendor's standard sales contract." Such contracts are designed to protect the vendor, often at the expense of the purchaser. They generally contain vague terms, warranty disclaimers, damage limitations, and integration clauses, or entire agreements, even though there is virtually no way a preprinted form can reflect all the negotiation between business parties. Prior to just a few years ago, buyers were reluctant to bring suit against sellers because they felt that they could not possibly win. Those same buyers willingly signed the standard contract forms because they did not know better. Potential buyers can learn two lessons from the experience of their predecessors:

1. Know your rights; and
2. Do not be afraid to assert them.

The buyer must first stand by his right to freely negotiate a contract with the vendor. If a vendor refuses to sign any contract but his own, then find a new vendor. Keep in mind, however, that an agreement should benefit both parties and the vendor has as much right to negotiate for terms favorable to himself as does the buyer.

Where should the contract for the purchase of a computer system start? Ideally, it should start with a complete description of the system—what it must accomplish and how it must work. Any express promise or affirmation of the system's ability, reliability, power, expertise, etc. made by the vendor or his agent (salesperson) ought to be included in the purchase agreement. This performance warranty clause is most important because it is written evidence of the system the purchaser has agreed to purchase and the vendor has agreed to sell. Hopefully, mistakes due to misunderstandings between the parties can be avoided by making reference to this clause. The vendor's express warranties should also be put into writing here because they may be disavowed by the vendor if left out.

Acceptance Testing Clause

The next most important clause for the buyer is an acceptance testing clause. While acceptance of goods normally takes place upon their delivery to the buyer, this clause permits the buyer to delay acceptance of the system until it has been tested and for a reasonable time thereafter. The testing is necessary to determine if the system is the one which was agreed upon, if it works in the manner agreed upon, and if it is able to do what the purchaser intended for it to do. Delay in acceptance until a reasonable time after testing has been completed is necessary to check the system for "bugs" which might not be readily apparent. Why is such a clause necessary? If the buyer discovers that the system received does not comply to the order, he may reject, rather than accept, it (UCC 2-601, 602). Then the seller may, under UCC 2-508, inform the buyer of his intention to cure and may substitute a confirming system within a reasonable amount of time. After acceptance has become effective, the buyer may revoke his acceptance if:

1. A "non-conformity substantially impairs its value to him" and
2. He accepted with knowledge of the defect but with "reasonable assumption" that the defect would be cured and it has not been, or
3. Without discovery of the defect "his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances." (UCC 2-608).

Thus, it is much simpler for the buyer to reject a system prior to acceptance than to revoke acceptance. For that reason, the buyer should attempt to get a long acceptance period—however, the acceptance period must be "reasonable."

Service and maintenance clauses should be included in the original contract for sale. These should specify what repairs will be done by the vendor and whether the buyer will be charged for them. This assures the parties of a continuing contractual relationship.

Warranties

Each vendor will encourage the buyer to accept disclaimers of warranties, but the buyer should be aware that he is disclaiming some very important rights. First, the buyer will be disclaiming the express warranties which should be written into the sales contract. If the vendor, or his agent, makes any promise or affirmation or gives a description or shows a sample of the system which becomes a "basis of the bargain," he creates an express warranty that the system will conform to that promise, affirmation, description or model (UCC 2-313). These express warranties may be disclaimed by "words or conduct . . . wherever reasonable." (UCC 2316 [1]) Where the express warranties have been written into the contract, the negative words or conduct would be inconsistent and the disclaimer would probably be inoperable.

UCC 2-314 identifies the implied warranty of merchantability. By this, the vendor warrants that the system will operate in the ordinary manner for which such a system is used. In order to disclaim this warranty, the disclaimer must be conspicuous, in writing, and must contain the word "merchantability." (UCC 2-316[2])

A cardinal rule is: "Never sign the vendor's standard sales contract."

The implied warranty of fitness for a particular purpose affords the buyer a great amount of protection where "the seller . . . has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods . . ." (UCC 2-315). In a computer system acquisition, the vendor ought to know "the particular purpose for which the goods are required" and the buyer will be dependent on the seller's skill to a certain extent, so it seems reasonable that the buyer would want to rely on this section should the system not perform as was intended. UCC 2-316[2] permits disclaimer of this warranty if it is conspicuous and in writing. The buyer should think carefully before disclaiming any of these warranties but vendors will probably be reluctant to sell without the disclaimers. An alternative would be to include a "limitation on damages" clause to protect the vendor should the buyer assert his rights upon breach of one of the above mentioned warranties.

Under UCC 2-714, upon seller's breach, buyer may recover damages equaling the difference between the value of the goods accepted and the value they would have had if they had been as warranted plus incidental and consequential damages. Such damages can be very high, so the seller may wish to limit possible damages by contract as permitted by UCC 2-719. Damages can be limited to return of the contract to the buyer, but are more likely to be limited to repair or replacement of the defective system. These can be optional remedies or the parties may expressly agree that they are to be the exclusive remedies. Where the exclusive remedy is repair and repeated repairs have failed to cure the defect, the remedy may be held to fail of its essential purpose, in which case the buyer may recover damages as outlined above (UCC 2-719[2]). Is this limitation of damages good for the buyer? It may be under some circumstances, such as where a minor adjustment will repair the defect in the system. However, the buyer might stand to lose a great deal where an irreparable system is essential to the business operation. In such case, incidental and consequential damages may be the proper award to compensate the buyer for repair costs and lost profits and the buyer should not sign a contract which denies him consequential damages.

These are a few of the items buyers should be aware of when purchasing computer systems. A wise buyer should know what he wants and how much he can give up in negotiation in order to get the concessions that are most important to him. If the warranties are most important to the buyer, then perhaps he ought to agree to a limitation on damages clause. It is for each buyer and seller to make their most acceptable contract.Ω

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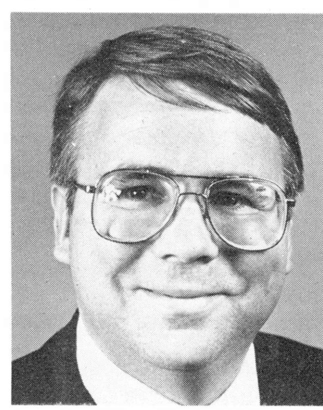

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Reviews

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Economics of Social Issues

6th Ed., by Richard H. Leftwich and Ansel M. Sharp, Business Publications, Inc., Plano, Texas, 1984, 428 pp.

Economics of Social Issues is not a new book, but the sixth edition of a college textbook. Originally published in 1974 and written for classroom use, this edition contains two new chapters and major revisions to three others. This textbook is designed to provide an analytical overview to the economic problems we face in our society today and the social impact of these problems on society as a whole. The authors have developed concepts and principles necessary to analyze the problems and then have applied these techniques to give some solutions to these.

The book is introduced by a lengthy chapter entitled "Human Misery—The Biggest Issue of Them All," in which Leftwich and Sharp discuss population, wants vs. means, our capacity to produce, living standards, causes of poverty, production and government's role. It is concluded with a discussion of the role of developed countries as they can and should aid the lesser developed countries with loans and gifts, technical assistance and joint aid programs through World Bank. At this point, the book divides into four parts. The first part—Resource Allocation—deals with what we have and the way it is divided—the second part deals with distribution, the third, stabilization through full employment and cost/push inflation, and finally, the fourth part deals with the public sector, governmental role and national debt. One chapter this reviewer found extremely well-written and informative was "Government Control of Prices." The authors' research, complete with meaningful charts and graphs, explained why governments control prices on selected items, market structure, economic analysis of price floors and ceilings, wages, rent controls and the impact of the significant increased costs on the households of the economy.

"The Impact of Higher Education—Who Really Benefits—Who Pays?" also goes into the problems in higher education. The financial crisis of many colleges—not enough money being spent—is society unwilling to support higher education? Who should pay? What is the product? Alternative institutional structure is discussed at length in this most informative chapter. Another chapter discusses energy in terms of adequacy, dependence on foreign suppliers, conservation and alternatives. "Crime and Its Prevention," another chapter, discusses the economic impact of crime, "illegal" vs. "immoral," and the effect of legalizing illegal activities.

The chapter on pollution, what can and should be done, and private property rights, are all important, pertinent issues. They are discussed in detail and alternative solutions presented. From an accounting viewpoint, the chapter on big business, monopolies, outputs and prices, and income distribution will probably be of most interest. Of course, the chapters dealing with consumerism and health issues should be of interest to us all. The authors devote considerable space to the discussion of shady business practices, the role of the government, provision of information and evaluation of the U.S. health care system, national health insurance and alternative proposals—all sure to provoke lively discussion.

Poverty—who and what, discrimination—the economic costs—what could and should be done, labor resources and the breaking up of human relationships within the family and outside it pinpoint the social effects of unemployment. The meaning and measurement of inflation as well as the process of creating money and the control thereof are other timely topics of this section.

The final chapters deal with governmental policies, tax equity and the national debt. There is a very good explanation of the national debt and the responsibility of government to incur debt only for the funding of profitable public investments (highways, parks) and to finance programs designed to stimulate employment.

The authors' stated purpose in this revision was to prepare the reader for the future by providing ideas, techniques and data for a quick and useful reference as well as a guide for future learning. The mission has been accomplished. A very well-written, concise overview of economics has been given here. Those persons reading and studying this book should have no difficulty in proceeding to more advanced courses on the subject. For those of us who simply need to know more, the book is a quick straightforward explanation of the basic elements of economics and a rather short but concise path to economic literacy.

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