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Outline of AICPA Accounting Research and Terminology Bulletins, final edition, prepared for GAO CPA review course

United States. General Accounting Office. Office of Staff Management

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OUTLINE of A I C P A
ACCOUNTING RESEARCH and TERMINOLOGY BULLETINS

FINAL EDITION

Prepared for

ADVANCED ACCOUNTING & AUDITING STUDY PROGRAM

UNITED STATES GENERAL ACCOUNTING OFFICE

OFFICE OF STAFF MANAGEMENT

WASHINGTON 25, D.C.

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INTRODUCTION

The American Institute of Certified Public Accountants has published a Final Edition of the Accounting Research and Terminology Bulletins. Generally, the purpose of the bulletins is to clarify, and to standardize to the degree desirable, certain accounting principles and procedures.

This memorandum presents a brief outline of their contents setting forth the definitions, conclusions and/or recommendations made by the Committee on Accounting Procedure, AICPA. This memorandum is not intended to replace the full discussion contained in the bulletins.

The Accounting Research and Terminology Bulletins are of particular importance to accountants since they represent the considered opinion of the most widely recognized authoritative spokesman for the profession. For candidates preparing for the CPA examination, a thorough knowledge of their contents is mandatory.

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GAO CPA REVIEW COURSE
OUTLINE OF
ACCOUNTING RESEARCH BULLETINS

BULLETIN #43 (Restatement and Revisions of Accounting Research Bulletins)

General:

1. No opinion issued by the committee is intended to have a retroactive effect unless it contains a statement of such intention.
2. The committee contemplates that its opinions will have application only to items material and significant in the relative circumstances.
3. The committee recognizes that in extraordinary cases fair presentation and justice to all parties at interest may require exceptional treatment.

Chapter 1 - Prior Opinions

Section a. - Rules Adopted by Membership

1. Unrealized profit should not be credited to income either directly or indirectly. A sale in the ordinary course of business is the usual criterion for realization of profit.
2. Capital surplus should not be used to relieve the income account of current or future year's charges. Exception: Quasi-reorganization. However, in this instance, the facts should be clearly disclosed.
3. Earned surplus of a subsidiary company created prior to acquisition does not form a part of the consolidated earned surplus; nor can any dividend declared out of such surplus properly be credited to the income account of the parent.
- 4a. Treasury stock may be shown as an asset only if properly disclosed (preferably shown in equity section).
- 4b. Dividends on treasury stock should not be credited to income.

5. Notes and accounts receivable from officers, employees, and affiliated companies should be shown separately in the balance sheet.
6. If a portion of stock issued for the acquisition of property is donated to the corporation at about the time of issuance, par value of the stock issued should not be recorded as cost of the property. If such donated stock is subsequently sold, proceeds should not be credited to surplus.

Section b. - Profits or Losses on Treasury Stock.

In a letter to members of the Institute issued in 1938, the following question was discussed:

"Should the difference between the purchase and resale prices of a corporation's own common stock be reflected in earned surplus (directly or through income) or should such difference be reflected in capital surplus?"

It was the opinion of the committee that such differences should be reflected in capital surplus.

Chapter 2 - Form of Statements

Section a. - Comparative Financial Statements

1. The committee recommends extension of the use of comparative statements as enhancing the significance of reports and bringing out more clearly the nature and trends of current changes affecting the enterprise.
2. Changes in accounting policies or procedures which affect comparability should be disclosed.
3. It is the auditor's responsibility to satisfy himself that the figures for the preceding year fairly present the position and results for the enterprise.

Section b. - Combined Statement of Income and Earned Surplus

1. The committee expresses approval of the presentation of a combined statement of income and surplus, where feasible, without recommending its general adoption.
2. The principal advantage of the combined statement is that it serves the purpose of showing both earnings applicable to the current period and modifications of earned surplus on a long-run basis.

3. The principal disadvantage of the combined statement is that income for the year will appear somewhere in the middle of the statement. If a combined statement is to be presented, care should be exercised to clearly indicate at what point income for the year appears.

Chapter 3 - Working Capital

Section a. - Current Assets and Current Liabilities

1. This section discusses the nature of current assets and current liabilities with a view to developing criteria as an aid to a more useful presentation in financial statements.
 - a. The discussion takes cognizance of the recent tendency of creditors to rely more upon the ability of debtors to pay obligations out of the proceeds of current operations than upon their ability to pay in case of liquidation.
 - b. The strict "one-year" interpretation of current assets and liabilities is ignored; the objective is to relate the criteria to the operating cycle of the business. (See Item 3 below.)
2. The term current assets is used to designate cash and other assets or resources commonly identified as those which are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business. This would generally include:
 - a. Cash available for current operations or its equivalent.
 - b. Inventories and operating and maintenance supplies.
 - c. Accounts, notes, and acceptances receivable.
 - d. Receivables from officers, employees, affiliates and others if collectible within a year.
 - e. Installment or deferred accounts and notes receivable if they conform to normal trade practices and terms within the business.
 - f. Temporary investments.
 - g. Prepaid expenses which, if not paid in advance, would require the use of current assets during the operating cycle.
3. The operating cycle is deemed the average time intervening between the acquisition of materials or services entering the manufacturing process and the final cash realization. (However, when the operating cycle is one year or less, one year should be used as the basis for segregation of current assets.)

4. This concept of current assets contemplates the exclusion therefrom of:
 - a. Restricted cash.
 - b. Permanent or continuing investments.
 - c. Receivables arising from unusual transactions and not expected to be collected within 12 months.
 - d. Cash surrender value of life insurance.
 - e. Unamortized costs of services received which are fairly chargeable to the operations of several years (deferred charges).
5. The basis of valuation of certain current assets, such as temporary investments and inventories, should be clearly disclosed in financial statements.
6. The term current liabilities is used to identify debts or obligations the liquidation or payment of which is reasonably expected to require the use of current assets or the creation of other current liabilities.
7. Current liabilities would include:
 - a. Obligations for items which have entered into the operating cycle.
 - b. Other liabilities requiring liquidation in a short period of time, usually 12 months.
 - c. Income tax liability even though not payable within 12 months.
 - d. Estimated or accrued amounts which are expected to cover expenditures within the year for known obligations. (Ex. Accrued bonus payments.)
 - e. Current installments of long term periodic payments.

Section b. - Application of U. S. Government Securities Against Liabilities for Federal Taxes on Income.

1. The usual procedure of showing U. S. Treasury Tax notes as a current asset (temporary investment) is proper, and especially so if the notes are to be used for purposes other than payment of the tax liability.
2. If other government securities may, by their terms, be surrendered in the payment of taxes, it is permissible to deduct such securities from the tax liability in the liability section of the balance sheet as long as the full amount of each is shown.

Chapter 4 - Inventory Pricing

This chapter deals with the general principles applicable to the pricing of inventories for mercantile and manufacturing enterprises. These principles are not necessarily applicable to non-commercial businesses or to regulated utilities.

1. The term "inventory" is used herein to designate the aggregate of those items of tangible personal property which (1) are held for sale in the ordinary course of business, (2) are in the process of production for such sale, or (3) are to be currently consumed in the production of goods or services to be available for sale.
2. A major objective of accounting for inventories is the proper determination of income through the process of matching appropriate costs against revenues.
3. The primary basis of accounting for inventories is cost, which has been defined generally as the price paid or consideration given to acquire an asset. As applied to inventories, cost means in principle the sum of the applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location.
4. Cost for inventory purposes may be determined under any one of several assumptions as to the flow of cost factors (such as "first-in first-out," "average," and "last-in first-out"); the major objective in selecting a method should be to choose the one which, under the circumstances, most clearly reflects periodic income.
5. A departure from the cost basis of pricing the inventory is required when the usefulness of the goods is no longer as great as its cost. Where there is evidence that the utility of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to physical deterioration, obsolescence, change in price levels, or other causes, the difference should be recognized as a loss of the current period. This is generally accomplished by stating such goods at a lower level commonly designated as "market."
6. As used in the phrase "lower of cost or market," the term "market" means current replacement cost (by purchase or by reproduction, as the case may be) except that:
 - a. Market should not exceed the net realizable value (i.e., estimated selling price in the ordinary course of business less reasonably predictable costs of completion and disposal); and
 - b. Market should not be less than net realizable value reduced by an allowance for an approximately normal profit margin.
7. Depending on the character and composition of the inventory, the rule of "cost or market, whichever is lower" may properly be applied either directly to each item or to the total of the inventory (or, in some cases, to the total of the components of each major category). The method should be that which most clearly reflects periodic income.

8. The basis of stating inventories must be consistently applied and should be disclosed in the financial statements; whenever a significant change is made therein, there should be disclosure of the nature of the change and, if material, the effect on income.
9. Only in exceptional cases may inventories properly be stated above cost. For example, precious metals having a fixed monetary value with no substantial cost of marketing may be stated at such monetary value; any other exceptions must be justifiable by inability to determine appropriate approximate costs, immediate marketability at quoted market price, and the characteristic of unit interchangeability. Where goods are stated above cost this fact should be fully disclosed.
10. Accrued net losses on firm purchase commitments of goods for inventory, measured in the same way as are inventory losses, should be recognized in the accounts. The amounts thereof should, if material, be separately disclosed in the income statement. (Note: When firm purchase commitments are adequately protected by firm sales contracts, the utility of such commitments is not impaired and, therefore, there is no loss.)

Chapter 5 - Intangible Assets

This chapter deals with problems of accounting for intangible assets pur-
chased, either individually or collectively with other assets, as opposed
to intangibles developed within a company by research, etc.

1. The intangibles considered may be broadly classified as follows:
 - Type (a). Those having a time of existence limited by law, regulation, agreement, or their nature (patents, copyrights, leases, etc., and good will if there is evidence of limited duration).
 - Type (b). Those not having a limited time of existence as above, and for which there is no indication of limited life (generally includes good will, going value, trade names, secret processes, etc.).
2. Intangibles of all types should be stated at cost. If cash is not paid, cost may be measured by the fair value of (a) the consideration given, or (b) the property acquired.
3. The cost of type (a) intangibles should be systematically amortized over the period benefited.
4. The cost of type (b) intangibles may be carried continuously until:
 - a. It becomes reasonably evident that their time of existence has become limited, in which event the cost should be amortized as in 3. above or, if such charges would result in distortion of the income statement a partial write down may be made to earned surplus, the balance to be amortized.

- b. It becomes reasonably evident that they have become worthless in which event the cost may be charged off to surplus or income, as deemed appropriate.
5. Excess paid by a parent over book value of equity acquired in a subsidiary should preferably be allocated as between tangible assets and intangible types (a) and (b) assets. The amounts allocated to intangibles should be treated as in 2, 3, and 4 above.
6. Lump-sum write-offs of intangibles should not be made to earned surplus immediately after acquisition, nor should intangibles be charged against capital surplus. If not amortized systematically, intangibles should be carried at cost until an event has taken place which indicates a loss or a limitation on the useful life of the intangibles.

Chapter 6 - Contingency Reserves

This chapter considers the accounting treatment of two types of reserves whose misuse may be the means of either arbitrarily reducing income or shifting income from one period to another:

- (a) General contingency reserves whose purposes are not specific;
 - (b) Reserves designed to set aside a part of current profits to absorb losses feared or expected in connection with inventories on hand or future purchases of inventory.
1. The committee is of the opinion that reserves such as those created:
 - (a) for general undetermined contingencies, or
 - (b) for any indefinite possible future losses, such as, for example, losses on inventories not on hand or contracted for, or
 - (c) for the purpose of reducing inventories other than to a basis which is in accordance with generally accepted accounting principles, or (See Chapter 4 above)
 - (d) without regard to any specific loss reasonably related to the operations of the current period, or
 - (e) in amounts not determined on the basis of any reasonable estimates of costs or lossesare of such a nature that charges or credits relating to such reserves should not enter into the determination of net income.
 2. It is the opinion of the committee that if a reserve of the type described above is set up:
 - (a) it should be created by a segregation or appropriation of earned surplus,

- (b) no costs or losses should be charged to it and no part of it should be transferred to income or in any way used to affect the determination of net income for any year,
- (c) it should be restored to earned surplus directly when such a reserve or any part thereof is no longer considered necessary, and
- (d) it should preferably be classified in the balance sheet as a part of shareholders' equity.

Chapter 7 - Capital Accounts

Section a. - Quasi-Reorganization or Corporate Readjustment

A rule was adopted by the Institute in 1934 which read as follows:

"Capital surplus, however, created, should not be used to relieve the income account of the current or future years of charges which would otherwise be made there-against. This rule might be subject to the exception that where, upon reorganization, a reorganized company would be relieved of charges which would require to be made against income if the existing corporation were continued, it might be regarded as permissible to accomplish the same result without reorganization provided the facts were as fully revealed to and the action as formally approved by the shareholders as in reorganiza-tion."

This section does not deal with the general question of quasi-reorganization, but only with cases in which readjustment, as permitted in the rule, is availed of by a corporation.

1. Procedure in readjustment (quasi-reorganization).
 - a. Make a clear report to stockholders and obtain their formal consent.
 - b. The readjustment of values should be reasonably complete. (Include all company assets.)
 - c. The effective date of the readjustment should conform closely to date of stockholders consent, and should not be prior to close of the last fiscal year.
 - d. Charge write-offs against (1) earned surplus to the extent thereof, and (2) the balance against capital surplus. Consolidated earned surplus should not be carried through a readjustment in which some losses have been charged to capital surplus.

- e. Assets should be carried forward from readjustment at a fair and not unduly conservative value, determined with due regard for the accounting rules to be employed.
 - f. Reserves may be set up to cover potential losses indeterminable in amount but known to have occurred prior to date of readjustment. If such reserves are subsequently found to be excessive or insufficient, balances should be carried to capital surplus.
2. Procedure after readjustment.
 - a. After readjustment a company's accounting should be similar to that appropriate for a new company.
 - b. Carry no earned surplus forward under that title. Create a new earned surplus account dated from the readjustment, and this dating should be disclosed in financial statements until such time as the effective date is no longer deemed to possess any special significance. (See Bulletin No. 46.)
 3. This statement deals only with readjustments wherein income or earned surplus accounts of the current or future years are relieved of charges which would otherwise be made thereagainst.

Section b. - Stock Dividends and Stock Split-Ups

This section deals with the issuance by a corporation of its own common shares to its own common shareholders without consideration moving from the shareholders to the corporation. A stock dividend involves an increase in the legal capital of the corporation, and is, therefore, distinguished from a stock split-up.

1. As to the recipient:
 - a. An ordinary stock dividend is not income to the recipient.
 - b. The cost of shares previously held should be allocated equitably to the total shares held after receipt of a stock dividend or split-up.
2. As to the issuing corporation:
 - a. Since the stock dividend implies a permanent capitalization of earned surplus, it is necessary that the board of directors:
 - (1) determine the aggregate amount to be capitalized.
 - (2) observe legal requirements as to the per share amount to be capitalized.
 - b. The amount capitalized should be charged to earned surplus and credited to capital stock, or to capital stock and capital surplus in an amount equal to the fair value of the additional shares issued.

3. Where it is clearly the intent to effect a stock split-up, no transfer from earned surplus to capital surplus or capital stock is called for, other than to the extent occasioned by legal requirements.
4. The committee believes that the corporation's representations to its shareholders as to the nature of the issuance is one of the principal considerations in determining whether it should be recorded as a stock dividend or a split-up.

Section c. - Business Combinations

This section has been superseded by Bulletin #48.

Chapter 8 - Income and Earned Surplus

The purpose of this chapter is to recommend criteria for use in identifying material extraordinary charges and credits which may in some cases and should in other cases be excluded from the determination of net income and to recommend methods of presenting these charges and credits.

1. In the "all-inclusive" income statement, net income is defined according to a strict proprietary concept by which it is presumed to be determined by the inclusion of all items affecting the net increase in proprietorship during the period except dividend distributions and capital transactions.
2. In the "current operating performance" type of income statement, the principal emphasis is placed upon the relationship of items to the operations and to the year, excluding material extraordinary items which are not so related and which would impair the significance of net income if included.
3. It is the opinion of the committee that there should be a general presumption that all items of profit and loss recognized during the period are to be used in determining the figure reported as net income. The only possible exception to this presumption relates to items which in the aggregate are material in relation to the company's net income and are clearly not identifiable with or do not result from the usual or typical business operations of the period.
4. Only extraordinary items such as the following may be excluded from the determination of net income for the year, and they should be excluded when their inclusion would impair the significance of net income:
 - a. Material charges or credits (other than ordinary adjustments of a recurring nature) specifically related to operations of prior years, such as the elimination of unused reserves provided in prior years and adjustments of income taxes for prior years;

- b. Material charges or credits resulting from unusual sales of assets not acquired for resale and not of the type in which the company generally deals;
 - c. Material losses of a type not usually insured against, such as those resulting from wars, riots, earthquakes, and similar calamities or catastrophes except where such losses are a recurrent hazard of the business;
 - d. The write-off of a material amount of intangibles;
 - e. The write-off of material amounts of unamortized bond discount or premium and bond issue expenses at the time of the retirement or refunding of the debt before maturity.
5. The following should be excluded from the determination of net income under all circumstances:
- a. Adjustments resulting from transactions in the company's own capital stock;
 - b. Amounts transferred to and from accounts properly designated as surplus appropriations, such as charges and credits with respect to general purpose contingency reserves;
 - c. Amounts deemed to represent excessive costs of fixed assets, and annual appropriations in contemplation of replacement of productive facilities at higher price levels; and
 - d. Adjustments made pursuant to a quasi-reorganization.
6. The committee has given consideration to the methods of presentation of the extraordinary items excluded in the determination of net income under the criteria set forth in item 4 above. One method is to carry all such charges and credits directly to the surplus account with complete disclosure as to their nature and amount. The committee believes that this method more clearly portrays net income. A second method is to show them in the income statement after the amount designated as net income.
7. When a combined statement of income and earned surplus is utilized, the committee's preference is that the figure of net income be followed immediately by the surplus balance at the beginning of the period.

Chapter 9 - Depreciation

Section a. - Depreciation and High Costs

The committee recognizes the problem that, in reporting profits today, costs of material and labor are expressed in terms of a "cheaper" dollar than that represented in the cost of productive facilities purchased at a lower price level. But it feels that to recognize current prices in

providing depreciation, it is necessary to formally record appraised current value for all properties. It does not believe such a drastic step should be taken, at least until a stable price level is reached. The committee expresses a general disapproval of charging to current income amounts in excess of depreciation based on cost in order to provide for replacement at higher prices.

Section b. - Depreciation on Appreciation

When appreciation has been entered on the books income should be charged with depreciation computed on the written-up amounts. A company should not at the same time claim larger property valuations in its statement of assets and provide for the amortization of only smaller amounts in its statement of income. When a company has made representations as to an increased valuation of plant, depreciation accounting and periodic income determination thereafter should be based on such higher amounts.

Section c. - Emergency Facilities--Depreciation, Amortization and Income Taxes

In this section the committee considers the problem of accounting for certificates of necessity under which all or part of the cost of emergency facilities may be amortized over a period of 60 months for income tax purposes.

1. Depreciation considerations:

- a. The committee is of the opinion that from an accounting standpoint there is nothing inherent in the nature of emergency facilities which requires the depreciation of their cost for financial accounting purposes over either a shorter or a longer period than would be proper if no certificate of necessity had been issued.
- b. The committee believes that when the amount allowed as depreciation for income-tax purposes is materially different from the amount of the estimated depreciation, the latter should be used for financial accounting purposes.

2. Recognition of income tax effects:

- a. When the income taxes payable during the amortization period is significantly less than it would be on the basis of the income reflected in the financial statements, the committee believes that a charge should be made in the income statement to recognize the income tax to be paid in the future on the amount by which amortization for income tax purposes exceeds the depreciation that would be allowable if certificates of necessity had not been issued.
- b. In accounting for this deferment of income taxes, the committee believes it desirable to treat the charge as being for additional income taxes. The related credit in such cases would properly

be made to an account for deferred income taxes. Under this method, during the life of the facility following the amortization period the annual charges for income taxes will be reduced by charging to the account for deferred income taxes that part of the income tax in excess of what would have been payable had the amortization deduction not been claimed for income-tax purposes in the amortization period. By this procedure the net income will more nearly reflect the results of a proper matching of costs and revenues.

Chapter 10 - Taxes

Section a. - Real and Personal Property Taxes

This section deals with the proper allocation of property tax expense between periodic income amounts and proper recognition of the tax liability at balance sheet date.

1. Accounting for property taxes:

- a. Generally, the most acceptable basis of providing for property taxes is a monthly accrual on the taxpayer's books during the fiscal period of the taxing authority for which the taxes are levied. The books will then show, at any closing date, the appropriate accrual or prepayment.
- b. Treatment in financial statements:
 - (1) Balance Sheet - An accrued liability for property taxes should be included as a current liability. When estimates are used, the liability should be described as estimated.
 - (2) Income Statement - (a) charge to operating expenses; (b) show as a separate deduction from income; or (c) distribute among the several accounts to which they are deemed to apply, such as factory overhead, selling or general expenses, etc.

Section b. - Income Taxes

This section deals with a number of accounting problems involved in the reporting of income taxes in financial statements.

1. These problems arise largely where:

- a. Material items affecting the computation of taxable income are not reflected in the income statement.
 - b. Material items included in the income statement do not affect the computation of taxable income.
2. When necessary and practicable, income taxes should be allocated to income and other accounts, as are other expenses. In cases in which transactions included in the surplus statement, but not in the income

statement, increase the income tax payable by an amount that is substantial and is determinable without difficulty, an allocation of income tax between the two statements would ordinarily be made. It is appropriate to consider the tax effect as the difference between the tax payable with and without including the item in the amount of taxable income.

3. When an item resulting in a material increase in income taxes is credited to surplus, the credit to surplus should be reduced by the portion of the current provision for income taxes attributable to the special credit; such reduction being carried to the income statement either as a deduction from income taxes or as a separate credit clearly described.
4. When an item resulting in a material reduction in income taxes is charged to surplus, a deferred-charge or a reserve account, the charge should be reduced by the portion of the reduction in income taxes attributable to the item, a charge being made to the income statement either as an increase in income taxes, or as a portion of the item in question equal to the tax reduction. The charge to the income statement should be clearly disclosed.
5. Additional income taxes for prior years or refunds on taxes of prior years should be included in the current income statement, and if material, they may be charged or credited to surplus indicating the period to which they relate.
6. Refunds arising from the "carry-back" of losses should be included in the income statement of the year in which the loss arises. If the amount is material, it should be shown as a separate item after the determination of operating income exclusive of the refund; or the amount of taxes payable for such year may be shown in the income statement, with the amount of tax reduction attributable to the "carry-back" indicated in either a footnote or parenthetically in the body of the income statement.
7. Provisions for income taxes for the current or prior years should be shown as current liabilities in the balance sheet. Claims for refunds under "carry-back" provisions should be shown as current assets.
8. If, because of differences between accounting for income tax purposes and accounting for financial purposes, no income tax has been paid or provided as to certain significant amounts credited to surplus or to income, disclosure should be made. If a tax is likely to be paid thereon, provision should be made on the basis of an estimate of the amount of such tax. This rule applies, for instance, to profits on installment sales or long-term contracts which are deferred for tax purposes.

Chapter 11 - Government Contracts

Section a. - Cost-Plus-Fixed-Fee Contracts

This section deals with accounting problems arising under cost-plus-fixed-fee contracts.

1. Fees under CPFF contracts may be credited to income on the basis of a measurement of partial performance which will reflect reasonable assured realization; such as delivery of completed articles.
2. Where CPFF contracts involve the manufacture and delivery of products, reimbursable costs and fees are ordinarily included in revenue.
3. Unbilled costs and fees under CPFF contracts are ordinarily receivables rather than advances or inventory, but should be shown separate from billed accounts receivable.
4. Offsetting of Government advances against amounts due from the Government on CPFF contracts is permissible to the extent allowed in the agreement, but a more desirable procedure is to make the offset only if that is the treatment anticipated in the normal course of business transactions under the contract. The amounts offset should be clearly disclosed.

Section b. - Renegotiation

This section deals with certain aspects of the accounting for those government contracts and subcontracts which are subject to renegotiation.

1. The financial statements of contractors should fully disclose the possibility of renegotiation of contracts.
2. In keeping with the established accounting principle that provision should be made in financial statements for all liabilities, including reasonable estimates for liabilities not accurately determinable, provision should be made for probable renegotiation refunds wherever the amount of such refunds can be reasonably estimated.
3. In addition to any provision made in the accounts, disclosure by footnote or otherwise may be required as to the uncertainties, their significance, and the basis used in determining the amount of the provisions, such as the prior years' experience of the contractor.
4. Provisions made for renegotiation refunds should be included in the balance sheet among the current liabilities.
5. Provisions made for renegotiation refunds should be included as current liabilities in the balance sheet, and preferably as deductions from sales in the income statement.

6. The committee recommends that the difference between the renegotiation refund and the provision therefore be shown as a separate item in the current income statement, unless such inclusion would result in a distortion of the current net income, in which event the adjustment should be treated as an adjustment of earned surplus.
7. The committee believes that a major retroactive adjustment of the provision made for a renegotiation refund can often best be disclosed by presenting a revised income statement for the prior year, either in comparative form in conjunction with the current year's financial statements or otherwise, it urges that this procedure be followed.

Section c. - Terminated War and Defense Contracts

This section deals with problems in accounting for fixed price war supply contracts terminated for the convenience of the Government.

1. Profits of the contractor accrue as of the date of termination.
2. Statements prepared subsequent to termination should include reasonably determinable termination claims. Material, but undeterminable, claims should be footnoted.
3. The termination claim should be shown as a current asset separately disclosed.
4. Advance payments received before termination may properly be shown as a deduction from the claim receivable. Loans negotiated on the security of the claim, should, however, be shown as current liabilities.
5. The contractor's cost and profit elements included in the claim should be accounted for as a sale, separately disclosed. Costs and expenses chargeable to the claim may then be given their usual classification.

Chapter 12 - Foreign Operations and Foreign Exchange

This section relates to the treatment of earnings from foreign operations, of foreign assets, of losses and gains on foreign exchange, and to the consolidation of foreign subsidiaries. The recommendations made in this chapter apply to United States companies which have branches or subsidiaries operating in foreign countries.

1. Treatment of earnings:

Earnings of U. S. companies from foreign operations should be reported in their own accounts only to the extent that funds have been received in the U. S. or unrestricted funds are available for transmission.

2. Consolidation of foreign subsidiaries:

- a. Foreign subsidiaries of U. S. companies may be excluded from consolidation of the parent and domestic subsidiaries, and summaries

of the foreign subsidiaries balance sheet and operating statements shown separately, or

- b. Consolidation may include the foreign subsidiary, but in any event,
 - c. The financial position and operating results of the foreign subsidiary must be clearly distinguishable from those of the parent and its domestic subsidiaries, either by separate statements or otherwise.
3. Losses and gains on foreign exchange:
- a. Realized losses or gains on foreign exchange should be charged against or credited to operations.
 - b. Provision for future declines in conversion value of foreign net current and working assets should be made and shown separately.
4. Translation of assets, liabilities, losses and gains:
- a. Current assets and current liabilities should be translated at the rate of exchange prevailing on the date of the balance sheet.
 - b. Fixed assets, permanent investments, and long-term receivables should be translated at the rates prevailing when such assets were acquired or constructed.
 - c. Long-term liabilities and capital stock should be translated at the rates prevailing when they were originally incurred or issued.
 - d. The operating statements of foreign subsidiaries should be translated at the average rate of exchange applicable to each month.

Chapter 13 - Compensation

Section a. - Pension Plans - Annuity Costs Based on Past Service

This section deals with the accounting treatment of costs arising out of past service which are incurred under pension plans involving payments to outside agencies such as insurance companies and trustees.

1. The committee is of the opinion that:
 - a. Costs of annuities based on past services should be allocated to current and future periods, except when immaterial, in which case they may be absorbed in the current year.
 - b. Costs of annuities based on past services should not be charged to surplus.
2. The above opinions stem from the theory that costs of annuities based on past services are generally incurred in contemplation of present and future services.

Section b. - Compensation Involved in Stock Option and Stock Purchase Plans

This section deals primarily with stock options granted by corporations to their officers and employees. Generally, such options are a part of the corporation's cost of the services of officers and employees, and should be accounted for as such.

1. The date on which such stock options are deemed to accrue may be:
 - a. The date of the option agreement.
 - b. The date the option right becomes the property of the grantee.
 - c. The date the grantee may first exercise the option.
 - d. The date the grantee exercises the option.
2. The committee prefers the recording of the accrual for stock options on the date the right becomes the property of the grantee.
3. The value of the compensation should be measured by the difference between the option price and the fair value of the stock at the date of the recording.
4. Accrual of the compensation should be made by means of a charge against the income account.
5. Until the options are exercised or expire, the obligations of the corporation should be adequately disclosed in the financial statements.

Chapter 14 - Disclosure of Long-Term Leases in Financial Statements of Lessees

This chapter discusses proper accounting disclosure of "sell-and-lease-back" arrangements.

1. It is the opinion of the committee that when rentals or other obligations under such long-term leases are material:
 - a. Disclosures should be made in the statements or in notes thereto of
 - (1) the amount of the annual obligations and the period to run, and
 - (2) any other important obligations or guarantee made under the lease.
 - b. The information in a. above should be given in the year of origination and all subsequent years when the amount is material.
 - c. Principal details of any important "sell-and-lease-back" arrangement should always be disclosed in the year of origination.
2. When the agreement is such that it is clearly evident that the lessee is, in substance, purchasing the property, by installment or otherwise, such property should be included in the assets of the lessee and the related liabilities and charges to income suitably accounted for.

Chapter 15 - Unamortized Discount, Issue Cost, and Redemption Premium on Bonds Refunded

This chapter discusses three methods of handling unamortized discount and redemption premium on bonds refunded.

1. Direct write-off to income or retained earnings:
 - a. It is acceptable accounting to write-off unamortized discount in full in the year of refunding.
 - b. Where a write-off is made to retained earnings, it should be limited to the excess of the unamortized discount over the reduction of current taxes to which the refunding gave rise.
 - c. The decision to charge the write-off to income or retained earnings should be governed by the materiality of the amount.
2. Amortization over the original life of the bonds refunded:
 - a. This method conforms more closely to current accounting opinion and should be regarded as preferable.
 - b. When this method is adopted, a portion of the unamortized discount equal to the reduction in current taxes resulting from the refunding should be deducted in the income statement and the remainder should be apportioned over the future periods.
 - c. This method has the merit of reflecting the refinancing expense as a direct charge under the appropriate head in a series of income accounts related to term of the original bond issue.
3. Amortization over the life of the new issue:
 - a. This method cannot be adequately supported by accounting theory and runs counter to generally accepted accounting principles.
 - b. The committee concludes that this method is unacceptable.
 - c. When this method is used, exception should be taken that the accounts do not conform to generally accepted accounting principle (except where this method is prescribed by regulatory bodies).
4. Other considerations:
 - a. It is acceptable to accelerate the amortization of the discount on bonds refunded except where such charges would materially distort the income figure.
 - b. The committee does not regard the charging of unamortized bond discount to capital surplus as an acceptable accounting treatment.

BULLETIN #44 - Declining-balance Depreciation

The declining-balance method of depreciation meets the requirements of being "systematic and rational."

1. In those cases where the expected productivity of the asset is relatively greater during the earlier years, or where maintenance charges tend to increase during the later years, this method may well provide the most satisfactory allocation of cost.
2. When a change to the declining-balance method is made for general accounting purposes, the change in method should be disclosed in the year in which the change is made.
3. The conclusions of this bulletin also apply to other methods, including the "sum-of-the-years-digits" method, which will produce substantially similar results.

BULLETIN #45 - Long-term Construction-type Contracts

This bulletin is directed to the accounting problems related to long-term construction-type contracts. There are two generally accepted methods followed by contractors.

1. Percentage-of-completion method:
 - a. The committee recommends that the recognized income be that percentage of estimated total income, either:
 - (1) that incurred costs to date bear to estimated total costs after giving effect to estimates of costs to complete based upon most recent information, or,
 - (2) that may be indicated by such other measure of progress toward completion as may be appropriate having due regard to work performed.
 - b. The principal advantages are:
 - (1) periodic recognition of income as work on the contract progresses, and
 - (2) a reflection of the status of the uncompleted contracts provided through the current estimates to complete.
 - c. The principal disadvantage is:
 - (1) it is necessarily dependent upon estimates of ultimate costs which are subject to the uncertainties frequently inherent in long-term contracts.

2. Completed-contract method:

- a. This method recognizes income only when the contract is completed. Costs of contracts in process and current billings are accumulated but there are no interim charges or credits to income other than provisions for losses.
- b. When this method is used, an excess of accumulated costs over related billings should be shown as a current asset and described as "costs of uncompleted contracts in excess of related billings." The excess of accumulated billings over related costs should be shown as current liability and described as "billings on uncompleted contracts in excess of related costs."
- c. The principal advantage is that it is based on results as finally determined, rather than on estimates for unperformed work.
- d. The principal disadvantage is that it does not reflect current performance when the period of any contract extends into more than one accounting period.

3. Selection of method:

- a. The committee believes that when estimates of costs to complete and extent of progress toward completion of long-term contracts are reasonably dependable, the percentage-of-completion method is preferable.
- b. When lack of dependable estimates or inherent hazards cause forecasts to be doubtful, the completed-contract method is preferable.
- c. The method followed should be disclosed.

BULLETIN #46 - Discontinuance of Dating Earned Surplus

The committee believes that the dating of earned surplus following a quasi-reorganization would rarely, if ever, be of significance after a period of ten years. It also believes that there may be exceptional circumstances in which the discontinuance of the dating of earned surplus could be justified at the conclusion of a period less than ten years.

BULLETIN #47 - Accounting for Costs of Pension Plans

This bulletin indicates guides which are acceptable for dealing with costs of pension plans in the accounts and reports of companies having such plans. The term pension plan is intended to mean a formal arrangement for employee retirement benefits.

1. The cost of pension plans to the employer usually is based in part on past services and in part on current and future services of the employees. The committee is of the opinion that past service costs should be charged to operations during the current and future periods benefited, and should not be charged to earned surplus at the inception of the plan.
2. Costs based on past services should be charged off over some reasonable period, provided the allocation is made on a systematic and rational basis and does not distort the operating results in any one year. The committee prefers this method as the one most likely to effect a reasonable matching of costs and revenues.
3. The minimum period presently permitted for tax purposes is ten years if the initial past-service-cost is immediately paid in full, or twelve years if one-tenth of the initial past-service cost plus interest is paid each year.

BULLETIN #48 - Business Combinations

This bulletin differentiates between two types of combinations, the first of which is designated as a purchase and the second as a pooling of interests, and indicates the nature of the accounting treatment appropriate to each type.

1. A purchase may be described as a business combination of two or more corporations in which an important part of the ownership interests in the acquired corporation is eliminated.
2. A pooling of interests may be described as a business combination of two or more corporations in which the holders of substantially all of the ownership interests in the constituent corporations become the owners of a single corporation which owns the assets and businesses of the constituent corporations. The continuance in existence of one or more of the constituent corporations in a subsidiary relationship to another does not prevent the combination from being a pooling of interests if no significant minority interest remains outstanding, and if there are important tax, legal, or economic reasons for maintaining the subsidiary relationship.
3. When a combination is deemed to be a purchase, the assets acquired should be recorded on the books of the acquiring corporation at cost, measured in money, or, in the event other consideration is given, at the fair value of such other consideration, or at the fair value of the property acquired, whichever is more clearly evident.
4. When a combination is deemed to be a pooling of interests, a new basis of accountability does not arise. The carrying amounts of the assets of the constituent corporations, if stated in conformity with generally accepted accounting principles and appropriately adjusted when deemed necessary to place them on a uniform accounting basis, should be carried forward.

5. Generally, one or more of the following circumstances give rise to a purchase:
 - a. Stock received by several owners of one of the predecessor corporations is not substantially in proportion to their respective interests.
 - b. Relative voting rights are materially altered through the issuance of senior equity or debt securities having limited or no voting rights
 - c. A substantial change in ownership occurring shortly before or planned to occur shortly after the combination.
 - d. If the management of one of the constituents is eliminated.
 - e. Where one of the constituent corporations is clearly dominant (for example, where the stockholders of one of the constituent corporations obtain 90% to 95% or more of the voting interest in the combined enterprise).
6. No one of the above factors would necessarily be determinative and any one factor might have varying degrees of significance in different cases. However, their presence or absence would be cumulative in effect.
7. Where one or more of the constituent corporations continues in existence in a subsidiary relationship, and the requirements of a pooling of interests have been met, the combination of earned surpluses in the consolidated balance sheet is proper since a pooling of interests is not an acquisition as that term is used in paragraph 3 of chapter 1(a) of Bulletin #43.

BULLETIN #49 - Earnings Per Share

1. This bulletin deals with problems which arise in the computation and presentation of statistics concerning periodic net income (or loss) in terms of earnings per share.

2. The committee now reaffirms its earlier conclusions that:

- (a) It is, in many cases, undesirable to give major prominence to a single figure of earnings per share;
- (b) Any computation of earnings per share for a given period should be related to the amount designated in the income statement as net income for such period; and
- (c) Where material extraordinary charges or credits have been excluded from the determination of net income, the per-share amount of such charges and credits should be reported separately and simultaneously.

3. In the computation and use of a single figure for earnings per share in this area of financial reporting, a clear explanation and disclosure of methods used are especially important.

4. The committee suggests the following general guides to be used in computing and presenting earnings per share:

- (a) Where used without qualification, the term earnings per share should be used to designate the amount applicable to each share of common stock or other residual security outstanding.
- (b) Earnings per share, and particularly comparative statistics covering a period of years, should generally be stated in terms of the common stock position as it existed in the years to which the statistics relate, unless it is clear that the growth or decline of earnings will be more fairly presented, e.g., in the case of a stock split, by dividing prior years' earnings by the current equivalent of the number of shares then outstanding.
- (c) In all cases in which there have been significant changes in stock during the period to which the computations relate, an appropriate explanation of the method used should accompany the presentation of earnings per share.

Single-Year Computations

5. In computing earnings per share for a single year, small changes in the number of shares outstanding during the year may be disregarded; the number of shares outstanding at the end of the year may be used as the base. Where there has been a substantial increase or decrease in the number of shares outstanding it is proper to use a weighted average of the number of shares outstanding during the year as the base. When these shares have been issued at the end of the year they may be disregarded in the computation. Where the increase may be attributed to stock split or dividend or the decrease may be attributed to a reverse stock split, the computation should be based on the number of shares outstanding at the end of the year. In determining the number of shares outstanding, reacquired shares should be excluded.

6. If there has been a stock split or reverse split after the balance sheet date but before the financial report is issued, it is desirable to base the earnings per share computation on the new number of shares, since the reader's interest is presumed to be in the present stock position. When computations of earnings per share reflect changes in the number of shares after the balance sheet date, it is important to disclose this fact since it might be presumed that the earnings per share are based on the number of shares shown on the balance sheet. It is equally important to disclose significant changes in the number of shares after the balance sheet date when such changes are not reflected in the earnings per share computation.

7. Where there are shares outstanding senior to the common stock or other residual security, the claims of such securities or net income should be deducted from net income or added to net loss before the computation of per-share figures, since earnings per share is ordinarily used to identify the amount applicable to each share of common stock or other residual security outstanding. In arriving at net income applicable to common stock for purposes of the per-share computations, provision should be made for cumulative preferred dividends for the year, whether or not earned. In the event of a net loss, the amount of the loss should be increased by any cumulative preferred dividends for the year. Where the dividends are cumulative only if earned, no adjustment of this nature is required except to the extent of income available therefor. In all cases the effect that has been given to dividend rights of senior securities in arriving at the earnings per share of common stock should be disclosed.

8. The following are special considerations relating to convertible securities:

- (a) When debt capital, preferred stock, or other security has been converted into common stock during the year, earnings per share should ordinarily be based on a weighted average of the number of shares outstanding during the year. When the weighted average is used, adjustments for the year in respect of interest or other related factors are not made.

- (b) When capitalizations consist essentially of two classes of common stock, one which is convertible into the other and is limited in its dividend rights until conversion takes place as, e.g., when certain levels of earnings are achieved, two earnings-per-share figures, one assuming conversion, are ordinarily necessary for full disclosure.

Comparative Statistics

9. Presentations of earnings-per-share data for a period of several years should be governed basically by criteria for single year presentations, but may involve special considerations. Variations in the capital structure may have substantial effects on earnings per share. The usefulness of comparative statistics depends in large measure on collateral historical information and disclosure of methods of computation used. The committee's recommendations which follow are intended as guides to uniformity but not as substitutes for explanations and disclosures.

10. When computations of earnings per share for a period of years include periods in which there have been stock splits or reverse splits, the earnings for periods prior to the dates of the splits should be divided by the current equivalent of the number of shares outstanding in the respective prior periods in order to arrive at earnings per share in terms of the present stock position. Stock dividends should be treated similarly except that it is permissible not to extend such treatment to small recurrent stock dividends. Where, during the period of years for which data are given, there have been issuances or reacquisitions of stock for property or cash or issuances in connection with conversions of debt capital, preferred stock, or other security, the computations of earnings per share for the years prior to such changes are not affected; it follows that earnings per share for these years should be based on the number of shares outstanding in the various years. When both situations have occurred, the effect of each should be reflected in accordance with the foregoing recommendations.

11. When equity securities are being publicly offered:

- (a) If there have been significant conversions of debt capital, preferred stock, or other security during the period of years for which data are given, it is appropriate to present supplementary calculations revising past figures to reflect subsequent conversions, on a pro forma basis.
- (b) If the securities being offered or their proceeds, are to be used to retire outstanding securities in circumstances which assure such retirement, it may be useful to present, in addition to otherwise appropriate calculations, supplementary computations to show pro forma earnings per share for at least

the most recent year as if such substitution of securities had been made. When this is done, the basis of the supplementary computation should be clearly disclosed. Where, however, the securities being offered, or their proceeds, are to be used, not to retire existing securities but for other purposes, earnings per share should be computed without adjustment for any increase in the number of shares anticipated as a result of such offering.

12. Where there has been a pooling of interests during the period of years for which data are given, in connection with which the number of shares outstanding or the capital structure has been changed, the method used in computing earnings per share for those years prior to the pooling of interests should be based on the new capital structure. When there is to be a pooling of interests in connection with which the number of shares outstanding or capital structure will be changed, earnings per share for any period for which income statements of the constituent companies are presented in combined form should be computed on a basis consistent with the exchange ratio to be used in the pooling of interest. In either case, earnings per share should be computed in conformity with the foregoing paragraphs.

Earnings Coverage of Senior Securities

13. Where periodic net income is related to outstanding shares of senior securities, i.e., preferred stock, under most circumstances, the term earnings per share is not properly applicable because of the limited dividend rights of these senior securities. Such information should not be designated as earnings per share but might be shown as the number of times or the extent to which the requirements of senior dividends have been earned.

Miscellaneous

14. In computing data relating to acquisitions, mergers, reorganizations, convertible and participating securities, outstanding stock options, retirements and combinations of these circumstances, a clear disclosure of the basis on which the computations have been made is essential and these situations and circumstances should all be dealt with in accordance with the recommendations contained in this bulletin.

Dividends Per Share

15. In general, dividends per share constitute historical facts and should be so reported. However, in certain cases, such as a stock split as mentioned in paragraph 10, a presentation of dividends per share in terms of the current equivalent of the number of shares outstanding at the time of the dividend is necessary so that dividends per share and earnings per share will be stated on the same basis. When dividends per share are stated on any basis other than the historical, it is generally desirable that such statement be supplemental to the historical record, and its basis and significance should be fully explained.

BULLETIN #50 - Contingencies

1. A contingency is an existing condition, situation or set of circumstances, involving a considerable degree of uncertainty, which may, through a related future event, result in the acquisition or loss of an asset, or the incurrence or avoidance of a liability, usually with the concurrence of a gain or loss.

DISCUSSION

2. This bulletin deals with contingencies which are not predictable enough to record in the accounts, but which might materially affect financial position or results of operations. Examples of contingencies are: pending or threatened litigation, possible assessments of additional taxes, claims against others for patent infringement, price redetermination upward and claims for reimbursement under condemnation proceedings. Material contingencies of these types should be disclosed in the Financial statements or in notes thereto.

3. Contingencies may exist where the outcome is reasonably foreseeable, such as anticipated losses from uncollectible receivables; these should be reflected in the accounts. However, contingencies which might result in gains usually are not reflected in the accounts since to do so might be to recognize revenue prior to its realization; but there should be adequate disclosure. (Probably footnote)

4. Contingencies that are inherent in business operations, such as the possibility of war, strike, business recession, need not be reflected in statements either by incorporation in the accounts or by other disclosure.

DISCLOSURE

5. Disclosure of contingencies referred to in paragraph 2 should be made in financial statements or in notes thereto. The disclosure should indicate the nature of the contingency, and should give an appraisal of the outlook. If a monetary estimate of the amount involved is not feasible, disclosure should be made in general terms, explaining that no amount is determinable. It may be appropriate to indicate a management opinion as to the amount which may be involved. Care should be exercised in the disclosure of contingencies in the case of gains or assets, to avoid misleading implications as to the likelihood of realization.

6. Certain other situations requiring disclosures have sometimes inappropriately been described as though they were contingencies, even though they do not possess the degree of uncertainty usually associated with a contingency. Examples are unused letters of credit, long term leases, assets pledged as security for loans, and commitments such as those for plant acquisition or an obligation to reduce debts, maintain working capital or restrict dividends. Even though these situations may develop into contingencies they should not be described (in the statements) as contingencies prior to such eventuality.

BULLETIN #51- Consolidated Financial Statements

Purpose of Consolidated Statements

1. The purpose of consolidated statements is to present the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company.

Consolidation Policy

2. Ownership of a majority voting interest is the usual condition for a controlling financial interest; ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company is a condition pointing toward consolidation. A subsidiary should not be consolidated where control is likely to be temporary. A subsidiary should be consolidated even though it has a relatively large indebtedness to bondholders or others.

3. In deciding upon consolidation policy, the aim should be to make the financial presentation which is most meaningful to the reader in view of the circumstances. Even though the group of companies have diverse operations, their statements may be consolidated. Separate statements might be preferable for one or more subsidiaries if this would be more informative to stockholders and creditors of the parent company.

4. A difference in fiscal periods of a parent and a subsidiary does not of itself justify the exclusion of the subsidiary from consolidation. Where the difference is not more than three months, use statements for the subsidiary's fiscal period and disclose material intervening events; otherwise prepare special statements for the subsidiary to use for consolidation.

5. Consolidated statements should disclose the consolidation policy being followed through headings, information in the statements, or a footnote.

Consolidation Procedure Generally

6. In preparing consolidated statements, intercompany balances and transactions should be eliminated including receivable-payable and similar balances, security holdings, sales and purchases, and gross profits and losses on assets remaining within the group.

Elimination of Intercompany Investments

7. Where the cost to the parent of the investment in a purchased subsidiary, after provision for specific costs or losses incurred in the integration of the operations, exceeds the parent's equity in the subsidiary's net assets, the excess should be dealt with in the consolidated balance sheet according to its nature. (1) Any difference attributable to specific tangible or intangible assets, should be allocated to them with proper provisions for depreciation or amortization over their remaining life. (2) Any difference which cannot be applied, should be shown among the assets in the consolidated balance sheet with a descriptive caption. (The CPA Course Staff suggests the caption in the "Intangible assets" section of the balance sheet be "Excess of cost over book value in subsidiary".)

8. In general, parallel procedures should be followed in the reverse type of case - where the cost to the parent is less than its equity in the net assets of the purchased subsidiary. Attributable differences should be allocated to specific assets, with corresponding adjustments to depreciation or amortization. Any difference which cannot be applied may be shown in a credit account. (The CPA Course Staff suggests the use of the caption "Excess of book value over cost" in the "Stockholders Equity" section of the balance sheet.)

9. The earned surplus or deficit of a purchased subsidiary at the date of acquisition by the parent should not be included in consolidated earned surplus.

10. When one company purchases several blocks of stock of another company at various dates and eventually obtains control, the date of acquisition (for the purpose of consolidated statements) depends on the circumstances. If the purchases are made over a period of time, the subsidiary earned surplus at acquisition should generally be determined on a step-by-step basis; however, if small purchases are made over a period of time and then a purchase is made which results in control, the date of the last purchase may be considered the date of acquisition.

11. When a subsidiary is purchased during the year, there are alternative ways of dealing with results of operations in the consolidated income statement. One method is to include the subsidiary in the consolidation as though it had been acquired at the beginning of the year, and to deduct (at the bottom of the income statement) the preacquisition earnings applicable to each block of stock. Another method is to include only the subsidiary's revenue and expenses subsequent to the date of acquisition.

12. When the investment in a subsidiary is disposed of during the year, it may be preferable to omit the details of the operations of the subsidiary from the consolidated income statement, and to show the equity of the parent in the earnings of the subsidiary prior to disposal as a separate item in the statement.

13. Shares of the parent held by a subsidiary should not be treated as outstanding stock in the consolidated balance sheet.

Minority Interests

14. Eliminate 100% of intercompany profit or loss (paragraph 6) regardless of the existence of a minority interest. (NOTE: The last sentence of this paragraph pertains to a consolidation method not used in the GAO course.)

15. If losses applicable to the minority interest in a subsidiary exceed the minority interest in the equity capital of the subsidiary, such excess and any further losses applicable to the minority should be charged against the majority interest. However, if future earnings do materialize, the majority interest should be credited to the extent of such losses previously absorbed.

Income Taxes

16. When separate income tax returns are filed, income taxes usually are incurred when earnings of subsidiaries are transferred to the parent. If

undistributed earnings of a subsidiary are to be transferred to the parent in a taxable distribution, provision for related income taxes should be made on an estimated basis at the time the earnings are included in consolidated income. There is no need to provide for income tax where the income has been permanently invested by the subsidiaries.

17. If income taxes have been paid on intercompany profits on assets remaining within the group, such taxes should be deferred or the intercompany profits to be eliminated in consolidation should be appropriately reduced.

Stock Dividends of Subsidiaries

18. The capitalization by subsidiary companies of earned surplus arising since acquisition does not require a transfer to capital surplus on consolidation,

Unconsolidated Subsidiaries in Consolidated Statements

19. The preferable method of dealing with this matter is to adjust the investment through income currently to take up the share of the controlling company in the subsidiaries' net income or net loss. The other method is to carry the investment at cost and to take up income as dividends are received. When the latter method is followed, the consolidated statements should disclose the cost of the investment in unconsolidated subsidiaries, the equity of the consolidated group of companies in their net assets, the dividends received from them in the current period, and the equity of the consolidated group in their earnings for the period.

20. If the investment in the subsidiaries is carried at cost plus the equity in undistributed earnings and intercompany sales are made between the unconsolidated subsidiaries and the parent company, and elimination of unrealized intercompany gains and losses should be made to the same extent as if the subsidiaries were consolidated. If the investment is carried at cost, it is not necessary to eliminate the intercompany gain on sales to unconsolidated subsidiaries, if the gain on the sales does not exceed the unrecorded equity in undistributed earnings of the unconsolidated subsidiaries. If such gain is material, it should be disclosed. Intercompany gains or losses on sales by unconsolidated subsidiaries to companies in the consolidation should be eliminated to arrive at the amount of equity in the undistributed earnings of the unconsolidated subsidiaries.

21. When the unconsolidated subsidiaries are material in relation to the consolidated financial position, summarized information should be given in footnotes or separate statements.

Combined Statements

22. There are circumstances where combined financial statements (as distinguished from consolidated statements) of commonly controlled companies are likely to be more meaningful than their separate statements, for example, (1) where one individual owns a controlling interest in several corporations with related operations; (2) unconsolidated subsidiaries; and (3) companies under common management.

23. In preparing combined statements, intercompany transactions and profits or losses should be eliminated. Problems in the area of minority interests, foreign operations, different fiscal periods, etc., should be handled in the same manner as in consolidated statements.

Parent-Company Statements

24. In some cases parent-company statements may be needed in addition to consolidated statements to show adequately the position of bondholders, other creditors, or preferred stockholders of the parent. Consolidating statements, using one column for the parent company and other columns for subsidiaries, are an effective means of presenting the pertinent information.

GAO CPA REVIEW COURSE
OUTLINE OF
ACCOUNTING TERMINOLOGY BULLETINS

The American Institute of Certified Public Accountants has published a final edition of Accounting Terminology Bulletins. Generally, the purpose of these bulletins is to promote uniformity in the use of terms in connection with business operations and financial statements.

This memorandum presents a brief outline of their contents setting forth the definitions, conclusions, and/or recommendations made by the Committee on Terminology, AICPA. This memorandum is not intended to replace the full discussion contained in the terminology bulletins.

These bulletins are of particular importance to accountants since they represent the considered opinion of the most widely recognized authoritative spokesman for the profession. For candidates preparing for the C.P.A. examination, a thorough knowledge of their contents is mandatory.

ACCOUNTING TERMINOLOGY BULLETINS

Bulletin #1

There follows a summary of the definitions and/or recommendations contained in this bulletin.

1. Accounting:

The art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.

2. Balance Sheet:

A tabular statement or summary of balances (debit and credit) carried forward after an actual or constructive closing of the books of account kept by double-entry methods, according to the rules or principles of accounting. The items reflected on the two sides of the balance sheet are commonly called assets and liabilities, respectively.

a. Asset (as a balance sheet heading):

A thing represented by a debit balance (other than a deficit) that is or would be properly carried forward upon a closing of books of account kept by double-entry methods, according to the

rules or principles of accounting. The presumptive grounds for carrying the balance forward are that it represents either a property right or value acquired, or an expenditure made which has created a property right, or which is properly applicable to the future. Thus, plant, accounts receivable, inventory and a deferred charge are all assets in balance-sheet classification.

b. Liability (as a balance-sheet heading):

A thing represented by a credit balance that is or would be properly carried forward upon a closing of books of account kept by double-entry methods, according to the rules or principles of accounting, provided such credit balance is not in effect a negative balance applicable to an asset. Thus the word is used broadly to comprise not only items which constitute liabilities in the popular sense of debts or obligations (including provision for those that are unascertained), but also credit balances to be accounted for which do not involve the debtor and creditor relation. For example, capital stock, deferred credits to income and surplus are balance-sheet liabilities in that they represent balances to be accounted for by the company; though these are not liabilities in the ordinary sense of debts owed to legal creditors.

3. Income Statement:

A statement which shows the principal elements, positive and negative, in the derivation of income or loss, the claims against income, and the resulting net income or loss of the accounting unit.

4. Retained Income:

The balance of net profits, income and gains of a corporation from the date of incorporation (or from the date when a deficit was absorbed by a charge against the capital surplus created by a reduction of the par or stated value of the capital stock or otherwise) after deducting losses and after deducting distributions to stockholders and transfers to capital-stock accounts when made out of such surplus.

5. Value:

As used in accounts signifies the amount at which an item is stated, in accordance with the accounting rules or principles relating to that item. Generally, book or balance sheet values (using the word "value" in this sense) represent cost to the accounting unit or some modification thereof: but sometimes they are determined in other ways, as for instance on the basis of market values or cost of replacement, in which cases the basis should be indicated in financial statements.

6. Audit:

In general, an examination of an accounting document and of supporting evidence for the purpose of reaching an informed opinion concerning its propriety.

7. Auditor's Report (or Certificate):

A document in which an independent accountant (or auditor) indicates briefly the nature and scope of the examination (audit) which he has made and expresses the opinion which he has formed in respect of the financial statements.

8. Depreciation:

Depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital asset, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation. Depreciation for the year is the portion of the total charge under such a system that is allocated to the year. Although the allocation may properly take into account occurrences during the year, it is not intended to be a measurement of the effect of all such occurrences.

9. Use of the term "Reserve":

Four accounting uses of the term "reserve" are discussed and recommendations made as follows:

- a. Valuation reserves (reserves for depreciation, bad debts, etc.). Discontinue the use of the word reserve in this sense and substitute terms which indicate the measurement process, such as "less estimated uncollectibles," "less estimated losses in collection," "less amortization to date," "less accumulated depreciation," "less depreciation to date," etc.
- b. Liability reserves (reserves for damages, taxes, self-insurance, etc.). Discontinue the use of reserve in this sense and substitute such terms as "estimated liabilities," or "liabilities of estimated amount."
- c. The term reserve is often used in connection with appropriations of retained earnings. This use is correct and may be continued.
- d. The term reserve is often used to describe a variety of charges, including losses estimated as likely to be sustained because of uncollectible accounts, depreciation, etc. It is to be noted here that the term refers to the charge by means of which a reserve (in any of the three preceding senses) is created.

10. Use of the term "Surplus":

The Committee on Terminology discusses the ambiguity and poor accounting usage of the term surplus, and presents the following recommendations:

- a. Use of the term "surplus" be discontinued.
- b. Contributed portions of proprietary capital be shown as:
 - i. Capital contributed for, or assigned to, shares outstanding, to the extent of par or stated value.
 - ii. Capital contributed for, or assigned to, shares in excess of par or stated value, and capital received other than for shares, whether from shareholders or others.
- c. Replace the term "earned surplus" with terms such as "retained income," "retained earnings," "accumulated earnings," or "earnings retained for use in the business." Show deficits as a deduction from contributed capital, with appropriate description.
- d. In connection with b.ii. and c. above, there should be clear indication of amounts appropriated or restricted as to withdrawal. Appropriations of retained income in the form of reserves should remain as part of stockholders equity.
- e. Designate stockholders equities arising from appreciation increments as "excess of appraised or fair value of fixed assets over cost," or "appreciation of fixed assets."

Bulletin #2

This bulletin considers the terms proceeds, revenue, income, profit, and earnings.

1. Proceeds:

Proceeds is a very general term used to designate the total amount realized or received in any transaction, whether it be a sale, an issue of stock, the collection of receivables, or the borrowing of money. Generally the term should be used only in discussions of transactions.

2. Revenue:

Revenue results from the sale of goods and the rendering of services and is measured by the charge made to customers, clients, or tenants for goods and services furnished to them. It also

includes gains from the sale of assets (other than stock in trade), interest and dividends earned on investments, and other increases in the owner's equity except those arising from capital contributions and capital adjustments. It does not include items such as amounts received from loans, owners' investments, and collection of receivables. The Committee on Terminology recommends that the term "revenue" be more widely used in the preparation of financial statements and for other accounting purposes.

3. Income and Profit:

Income and profit involve net or partially net concepts and refer to amounts resulting from the deduction from revenues, or from operating revenues, of cost of goods sold, other expenses, and losses, or some of them. The terms are often used interchangeably and are generally preceded by an appropriate qualifying adjective or term such as "gross," "operating," "net....before income taxes," and "net." The terms are also used in titles of statements showing results of operations, such as "income statement" or "statement of profit and loss." The committee recommends that when the terms are used in financial statements, they be preceded by the appropriate qualifying adjective. When referring to the excess of operating revenue over the cost of goods sold, the terms "gross profit on sales" or "gross margin" are preferred. It is also recommended that the terms "operating income," "net income" and "income statement" be used.

4. Earnings:

The term earnings is not used uniformly but it is generally employed as a synonym for "net income," particularly over a period of years. The term is often combined with another word in the expression "earning power", referring to the demonstrated ability of an enterprise to earn net income. The committee makes no recommendation at this time.

Bulletin #3

This bulletin considers the term book value.

Book value signifies the amount at which an item is stated in accordance with the accounting principles related to them. The committee recommends that the use of the term book value in referring to amounts at which individual items are stated in books of account or in financial statements, be avoided, and that instead, the basis of amounts intended to apply to individual items be described specifically and precisely; for example, cost less depreciation, lower of cost or current replacement cost, or lower of cost or selling price.

Bulletin #4

This bulletin considers the terms cost, expense, and loss.

1. Cost:

Cost is the amount, measured in money, of cash expended or other property transferred, capital stock issued, services performed, or a liability incurred, in consideration of goods or services received or to be received. Costs can be classified as unexpired or expired. The committee recommends that the term cost be used when appropriate in describing the basis of assets as displayed in the balance sheet, and properly should be used in income statements to describe such items as cost of goods sold, or costs of other properties or investments sold or abandoned.

2. Expenses:

Expense in its broadest sense includes all expired costs which are deductible from revenues. While the term expense is useful in its broad and generic sense in discussions of transactions and as a general caption in income statements, its use in financial statement is often appropriately limited to the narrower sense of the term, such as operating, selling or administrative expenses, interest, and taxes. In any event, items entering into the computation of cost of manufacturing, such as material, labor, and overhead, should be described as costs and not as expenses.

3. Loss:

Loss is (a) the excess of all expenses, in the broad sense of that word, over revenues for that period, or (b) the excess of all or the appropriate portion of the cost of assets over related proceeds, if any, when items are sold, abandoned, or either wholly or partially destroyed by casualty or otherwise written off. The committee recommends that the term loss be used in financial statements in reference to net or partially net results when appropriate in place of the term income or profit as described in Bulletin #2, item 3 above. In such cases the term should generally be used with appropriate qualifying adjectives. It should also be used in describing results of specific transactions, generally those that deal with disposition of assets.