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Eight Years with the Accounting Principles Board

HOW IT FEELS TO BE A GORED OX

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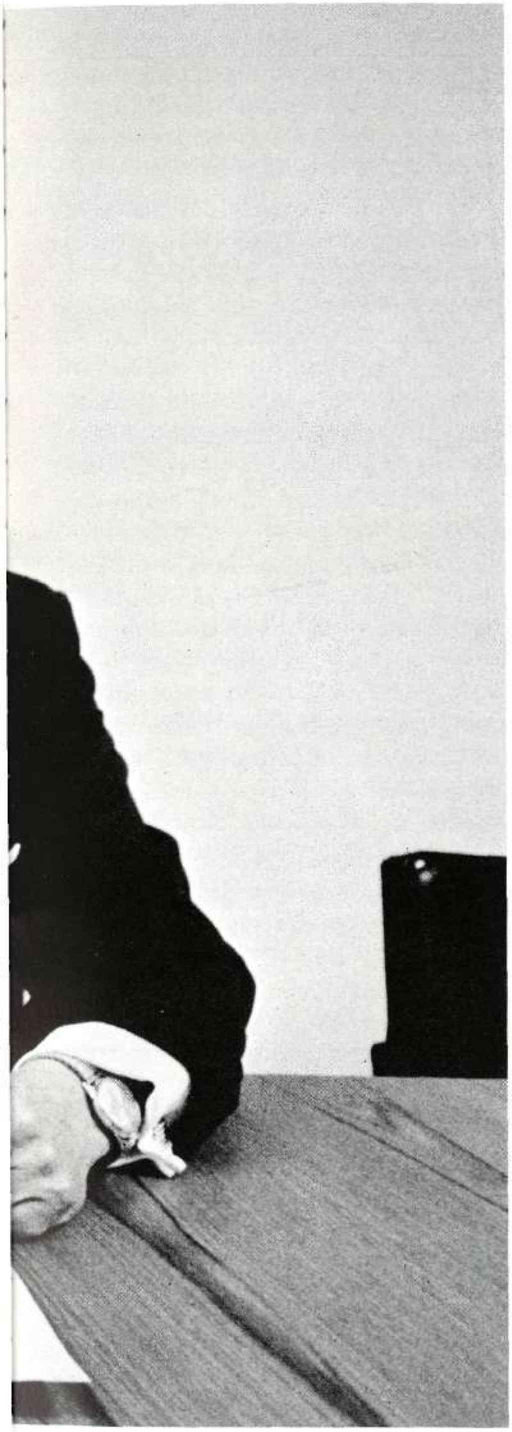

Risks and Rewards

"My greatest experience in 40 years of public accounting," says Donald Bevis, "was my tenure on the APB, from 1965 until the Board's demise in 1973, when it was succeeded by the Financial Accounting Standards Board."

As a measure of his experience, he cites the number of Board pronouncements during that eight-year period:

- 26 Opinions (Nos. 6 through 31) and approximately 200 Accounting Interpretations of these Opinions;
- 3 Statements;
- 7 Accounting Research Studies;
- 19 Industry Audit and Accounting Guides. (The stated accounting principles and practices of these guides required the approval of the APB.)

"During that period," he says, "I conversed with the most knowledgeable and capable accountants in the profession—in practice, industry, government, and the academe. These discussions, plus others with people in the financial community, greatly influenced my decisions on accounting issues. An initial conclusion was not necessarily the final one. I also learned to appreciate that there is more than one informed opinion on any accounting principle or its application.

"Considering the fact that APB work was voluntary," he says, "it was amazing to note the amount of time spent. For many members, including myself, it became almost a full-time duty: board meetings, committee meetings, night sessions, reams of correspondence, public hearings, draft pronouncements, and other activities. To this must be added the volunteered time of observers and advisers to Board members and those working on Industry Audit and Accounting Guides and Board-authorized research studies. In addition, one cannot overlook the time freely given by personnel of the SEC and other government bodies, together with the efforts of industry and accounting organizations, in developing information and commentary on proposed pronouncements. Finally, invaluable service was rendered by the AICPA staff. I would estimate that in the last several years, when the output was greatest, the annual cost was close to $2.5 million. This compares to a proposed annual cost of $3.5 million for the FASB."

All of the material accumulated by the Board concerning its unfinished business has been made available to the FASB. These include Industry Audit and Accounting Guides and Accounting Research Studies in process. Some of the unfinished APB items are on the first priority list of FASB.

Criticisms of the Board

It is often said that the Accounting Principles Board did not deal with fundamental issues but spent too much time "putting out fires." I believe, however, that a rereading of the Opinions and Statements will demonstrate that the APB did deal with many fundamental issues on accounting principles and financial reporting.*

Furthermore, because of the rapidly changing business and economic environment, it was necessary to put out fires, ignited in some cases by

*Good examples are the Opinions on Accounting for Income Taxes, Reporting the Results of Operations, and The Equity Method of Accounting for Investments in Common Stock.

avant garde methods of "front loading"—although a few flared up beyond the capacity of the fire department to handle in a satisfactory manner. The delay or failure in putting out some fires arose either from the need to obtain the required background information and reconcile different points of view before a sound pronouncement could be issued, or because other items had a higher priority on the agenda. Even FASB, however, a completely full-time organization dealing with fundamental issues on a more timely basis, will still have to put out fires.

Another complaint was that the Board did not deal directly with the objectives of financial statements and financial reporting. It was contended the Board should have resolved this pervasive subject early in its history, in order that attempts at codification of proper accounting principles would be productive. There is considerable validity to this criticism, but volunteer bodies cannot always resolve issues as soon as the critics would like. FASB has the matter high on its agenda, and has released a discussion memorandum embodying the Trueblood Committee Report on "Objectives of Financial Statements." But we should not expect overnight implementation; after all, it took the Objectives Study Group two years to prepare its report issued in 1973.

The Board lacked independence, according to some critics. It was suggested that the individual members, and hence the Board itself, lacked independence because the members were subjected to pressures from clients of their firms. This was far from the truth. Each firm had clients who took opposite positions on many issues. Board members openly disagreed with other partners in their firms. Quite often the individual firms could not reach a unanimous position on controversial issues. Compromises were necessary. In my opinion, Board members sat down with objectivity and attempted to resolve all issues on their merits. Even though the Board acted with independence, it may have lacked the appearance of independence, so critical in obtaining public acceptance of its pronouncements.

Pressures that did hurt the accomplishments of the Board arose from industry critics, letter-writing campaigns to Congressmen initiated by industry, lack of support at critical times by the SEC, and, in some cases, lack of support from fellow members of the practicing profession (e.g., a proposed amendment in 1969 to the Code of Professional Conduct, requiring disclosure of departures from APB Opinions, narrowly failed to receive the necessary two-thirds affirmative votes). FASB, of course, can't be criticized for lack of independence because its members are occupied full-time with their activities and have disassociated themselves from their former firms or employers. It remains to be seen what adverse actions may come from letter-writing campaigns to Congress or from the SEC.

In recent months the SEC has emphasized a distinction between accounting disclosure ("their province") and accounting measurement (FASB responsibility). The distinction appears to be artificial and must be resolved if FASB is to accomplish its goals, and if the establishment of accounting principles is to remain in the private sector. In this connection, it should be noted that on December 20, 1973, in Accounting Series Release No. 150, the Commission reaffirmed its long standing policy "of looking to the private sector for leadership in establishing and improving accounting principles and standards through the FASB, with the expectation that the body's conclusions will promote the interests of investors."

The Board allegedly did not give adequate representation to issuers and users of financial statements in the determination of accounting principles; as an arm of the AICPA, it appeared to be both legislative and executive. Here again, there is some justification for this complaint. In the new FASB, however, both the requirements for membership and the operating procedures provide for greater participation and input by issuers and users. But FASB must demonstrate that it can develop and maintain the legislative "clout" and prestige that will be so necessary to avoid power conflicts between the interested groups. The APB lacked the prestige to minimize these conflicts.

The APB did not always have adequate research to support its conclusions, critics said. This was true in some cases, but if the Board had waited because of the political significance of some issues, it might well have resulted in "locking the barn after the horse was stolen." In the minds of many, issuance of the most-criticized Opinions did stop many of the abuses. In partial defense of the APB, it should be noted that the discussions with industry and other organizations, public hearings, and the formal exposure process did not always elicit all the problem areas that had arisen or would arise if the proposed Opinion were to be issued. Responsibility for this arose through failure of some respondents to give adequate consideration to all sides of the subject matter. More often than not, on controversial issues the name of the game was destructive criticism—not constructive criticism. Research was delayed in some cases because the time of the AICPA research staff was used to draft and revise proposed Opinions and Statements.

There were two complaints which were completely opposite. Some contended that the Opinions dealt primarily with principles and did not state how they should be implemented. Others contended that the Opinions were "cookbooks"; they should have been limited to principles, leaving the application up to the judgment of issuers of financial statements and their auditors. While some change in format might have been made, the Board believed that in highly technical and controversial issues it was necessary to go into considerable detail to avoid misapplication of its conclusions. In other cases where the conclusions were quite clear, the Board did not believe it was necessary to prescribe the bookkeeping.

Finally, the critics say the Board, which included the author of this article, accepted too many compromise positions. In a democracy, you must reconcile different points of view if progress is to be achieved. Politics also has a role in establishing accounting principles. Some progress is always better than none. Apropos of this complaint, some critics said, if Opinions of the APB were compromises, why did some members qualify their assent or dissent. It must be remembered that the adoption of Opinions required a two-thirds favorable vote on the issues. The APB did not operate in an atmosphere of dissent. But even with compromises, some members still qualified their assents or dissents because they could not agree on all parts of the solution that had been reached.

Strengths of the Board

The strengths of the Board have been mentioned above. In summary, they were:

1. *Accounting expertise*. Members of the Board were some of the most knowledgeable and capable accountants in the country. All had direct contacts with many other experts on specific issues.

2. *Dedication*. Although service on the APB was voluntary, its members were dedicated to the determination of sound accounting principles. Availability of time was not a major limiting factor.

3. *Integrity*. Board members maintained their independence at all times. They only changed their conclusions when the weight of evidence and support was against them.

4. *Objectivity*. Board members approached all issues on the basis of their merits. They were not influenced by unsupported special interests and so-called "popularity contests." Compromises were necessary to reconcile strong opposing points of view.

Weaknesses of the Board

For equal time, I will summarize the weaknesses of the Board. They were:

1. It was not a full-time body and lacked the time and resources to resolve some important issues.

2. It did not establish the objectives of financial statements and financial reporting.

3. The input from issuers and users of financial statements was inadequate in some cases.

4. Research, both basic and applied, was lacking in some cases.

The Beginning of the End

By 1969, the Board had gained considerable public respect and stature, although it had not accomplished as much as some people expected. (It was established in September 1959, when it assumed the responsibilities of the former committees on accounting procedure and on terminology.) It had overcome the criticisms growing out of the "investment credit" fiasco, a situation that almost resulted in the death of the APB—which is perhaps worth going into here.

In December 1962, the APB issued its Opinion No. 2, Accounting for the "Investment Credit," concluding "that the allowable investment credit should be reflected in net income over the productive life of acquired property and not in the year in which it is placed in service." Some accountants and businessmen refused to abide by the Opinion, and the SEC backed down in 1963 from its initial support, with the result that the APB was forced to amend the Opinion. Opinion No. 4 (March 1964) permits treating the credit as a reduction of federal income taxes of the year in which the credit arises, or spreading it over the productive life of the related property.

In mid-1967, in the exposure draft of Opinion No. 11, Accounting for Income Taxes, the APB again tried to establish that there was only one way to account for investment tax credits—they should be reflected in income over the life of the related assets. Again, some accountants and businessmen and the SEC refused to support the conclusion, and the subject was dropped from the Opinion.

In 1969 the Board began a re-examination of Accounting Research Bulletin No. 48, Business Combinations (issued in January 1957). The application of this bulletin, with the acquiescence of the SEC, became so watered down that there was no logical standard for accounting for business combinations. Clamor arose from all sides for its revision and the stopping of abuses practiced under the guise of generally accepted accounting principles.

The APB's initial position would have barred pooling-of-interests accounting. Intense pressures on the Board were exerted by the profession and by industry in this highly emotional and controversial issue. The Board foundered. It backed away step-by-step from what many considered to be the most important criterion, if pooling-of-interests accounting was to be permitted (from a 3 to 1 size test, to a 9 to 1 size test, and then to no size test). But something had been done; a weak Opinion (but not as weak as the one before) was issued in August 1970 (Opinion No. 16—Business Combinations). There was, however, general dissatisfaction with the result. The "quality of earnings" of a post-merger company was still suspect. From this point forward there was a distinct loss of confidence in the Board. It had yielded to pressures.

Shortly thereafter, the American Accounting Association, the academics' organization, appointed a committee to look into the establishment of generally accepted accounting principles. That committee discontinued its activities when the AICPA, early in 1971, appointed two committees—the Study Group on Establishment of Accounting Principles and the Study Group on the Objectives of Financial Statements.

The same year, 1971, also saw several other events and debacles which had a deleterious impact on the effectiveness and activities of the APB. Congress, at the request of some businessmen and professional accountants, and despite strong support of the APB position (the same as in 1967) by the SEC, specified in law how to account for the investment credit. The options permitted under Opinion No. 4 were continued.

In 1968, the Board had begun an intensive study on accounting for marketable securities. By 1971, it was prepared to issue an exposure draft which would have required carrying such securities in the balance sheet at current market values and reflecting the unrealized gains or losses in current income. The insurance industry objected. Other proposals were suggested but there were always strong objections from influential sources. The SEC did not support the APB; the matter died.

Other blows to the Board soon followed. For several years it had been considering accounting in the extractive industries. However, the Federal Power Commission issued a regulation requiring "full cost" accounting by natural gas pipeline companies. This occurred despite a request from the Board to hold up any regulation until the Board had completed its study.

Accounting for leases was also high on the agenda of the APB. Preliminary discussions had been held with interested parties but no conclusions had been reached. However, in an attempt to forestall any requirements for capitalization of leases, lobbying in Congress began. It was contended that any such requirement would seriously disrupt a major factor in the economy of the country. Resolution of the issue by the Board was dropped.

By the end of 1971, the demise of the Board was clearly predictable. The Board had not been able to cope with the environment in which it operated. Public trust had not been established. The ox had been gored.

What Did the APB Accomplish?

The Board believed that financial accounting could be made a rational discipline, but it was faced with both intellectual and political problems. Despite these problems, the Board did make considerable progress in improving financial reporting:

1. Financial accounting, it said, should recognize the economic substance of events or transactions, even though the legal form differs.
2. Improved disclosures in reporting were required.
3. Areas of difference in accounting and reporting were narrowed.
4. Recognition of "current value" accounting in contrast to historical cost accounting received increasing attention.
5. "Front loading" of income was severely restricted.

Good Opinions

The Opinions briefly discussed below provide some evidence of the accomplishments of the APB.

No. 8—Accounting for the Cost of Pension Plans (November 1966). This Opinion states that the establishment of a pension plan implies a long-term undertaking, and that, accordingly, pension costs should be recognized annually, even though there may be legal limitations. The Opinion needs updating in view of experiences in the past eight years, new developments in pension plans, and recently enacted legislation.

No. 9 — Reporting the Results of Operations (December 1966). This Opinion established that the "all-inclusive" concept should be followed in income reporting, rather than the "current operating performance" concept. Direct entries of profit and loss items to retained earnings were ruled out.

No. 11—Accounting for Income Taxes (December 1967). This Opinion required comprehensive interperiod tax allocation in the determination of income tax expense, even though there was no legal liability at the time. In my opinion, the question of the use of the "deferred method," instead of the "liability method," should now be reconsidered. Further, the accounting for income taxes in special areas (see APB Opinion No. 23) needs re-examination. There can be only one proper method of accounting for incentive tax credits and that matter should also be covered in any revision.

No. 18—The Equity Method of Accounting for Investments in Common Stock (March 1971). This Opinion requires the application of the equity method of accounting for certain investments in common stock that are 50 percent or less of the voting power —in order to give some recognition to their changing value.

No. 19—Reporting Changes in Financial Position (March 1971). This Opinion requires the inclusion of a statement of changes in financial position as a basic financial statement.

No. 20—Accounting Changes (July 1971). This Opinion eliminated the areas of difference in reporting accounting changes.

No. 21—Interest on Receivables and Payables (August 1971). This Opinion requires the imputation of interest when the face amount of the obligation does not represent the present value of the consideration given or received in the exchange.

No. 22—Disclosure of Accounting Policies (April 1972). As the title indicates, this Opinion requires the disclosure of all significant accounting policies.

No. 28—Interim Financial Reporting (May 1973). This Opinion extends the applicability of generally accepted accounting principles to interim financial reporting.

No. 29—Accounting for Non-monetary Transactions (May 1973). This Opinion narrowed the areas of difference in accounting for such transactions.

No. 30—Reporting the Results of Operations (June 1973). This Opinion eliminated areas of difference, and established more definitive disclosure requirements in reporting on certain events and transactions. The Opinion was also needed to stop the rapidly developing practice of recording debits to income from unusual transactions as extraordinary items, and credits to income from such transactions as ordinary items.

Poor Opinions

No. 4—Accounting for the "Investment Credit"—amending APB Opinion No. 2 (March 1964). Nothing further need be said about Opinion No. 4. The events surrounding it almost disrupted any progress in accounting.

No. 5—Reporting of Leases in Financial Statements of Lessee (September 1964). The Opinion provided that leases should be capitalized if the terms of the lease resulted "in the creation of a material equity in the property." However, the definition of creation of a material equity was inconclusive and little good came from the Opinion.

No. 14—Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants (March 1969). In APB Opinion No. 10, the Board stated with considerable logic that the portion of the proceeds attributable to the conversion feature of convertible debt should be accounted for as paid-in capital. This action was reversed in No. 14 because of the "purported" inseparability of the debt and the conversion option, and because of the difficulties of implementation. The conclusion led to other nonsequiturs, like the requirement in No. 26, Early Extinguishment of Debt, that any gain or loss on the extinguishment of convertible debt should be recognized in income and cannot be an adjustment of capital.

No. 16—Business Combinations (August 1970). The history and results of issuance of this Opinion have already been referred to.

Other Opinions

One other Opinion deserves some comment. *No. 15—Earnings Per Share (May 1969).* This has been criticized because of its internal complexity and arbitrary rules. Further, over 100 interpretations of the Opinion were subsequently issued. Nevertheless, in view of the business environment and the emphasis on earnings per share at the time, it was essential that the Board take some stand on the subject. Uniformity in practice had to be established.

Conclusion

Obviously, I hope the FASB will learn from the experience of the APB. The APB started with great expectations. The FASB will need the support of all interested parties if it is to succeed. Bitter and acrimonious debate must yield to objectivity and constructive cooperation. The espousal of personal interests must be secondary.

On a personal note, the benefits of eight years with the Accounting Principles Board cannot be evaluated. There is no way to assign a dollar value to the education I received, to the many new friendships created, and more importantly to the contributions of many to the development of sound accounting practices. The Board rests—in peace.