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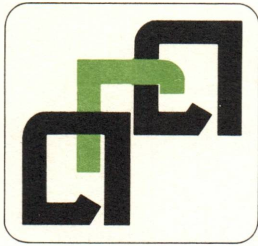

Accounting Research Association newsletter

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, 666 FIFTH AVE., NEW YORK, N.Y. 10019

Vol. III, No. 1 February 2, 1970

APB VOTES EXPOSURE OF TWO DRAFT OPINIONS

At its January 21-24 meeting the Accounting Principles Board decided to issue for broad public exposure draft Opinions on accounting for business combinations and goodwill and on reporting changes in accounting methods in financial statements. (See ARA Newsletter Dec. 15, 1969.) Single copies of the accounting changes draft will be sent to ARA member firms for comment in about two weeks, followed later in the month by the draft on business combinations.

Business Combinations: As previously reported, the Board's tentative position calls for business combinations to be accounted for by either the purchase or pooling of interests method, but not as alternatives. Most combinations would be treated as purchases and procedures for the purchase method are given in the draft. However, if all conditions specified in the draft for pooling were met, this method would be required. Among the conditions for using pooling of interests are:

...The voting common stock interest of each combining company is at least one-third that of each of the other parties to the merger.

...The plan is carried out within one year and effected by issuing common stock for substantially all of the common stock interest of another company.

...A combining company which does not issue the common stock to effect the combination may pay only normal dividends and reacquire only a normal number of shares of treasury stock during the period that the plan of combination is being consummated.

...The combination agreement does not provide for (a) any future issuance of additional shares or payment of other consideration on the basis of some event or other contingency or (b) the direct or indirect retirement or reacquisition in the future of any of the shares issued to effect the combination.

...The surviving combined corporation does not plan to dispose of a substantial part of the assets of the formerly separate companies within two years.

The draft Opinion also states that the cost of all intangible assets acquired in a purchase should be recorded and should be charged to income over the estimated benefit period, but not to exceed forty years.

Accounting Changes: The draft Opinion on the treatment of changes in the application of accounting principles and methods proposes that the new basis be used in preparing current year financial statements and that retroactive restatement of financial data to conform to the new basis be made for all past periods affected by the change.

(continued)

NEW STATEMENT ON AUDITING PROCEDURE DEALS WITH INDEPENDENCE

SAP No. 42, "Reporting When A Certified Public Accountant Is Not Independent" clarifies the auditor's position and specifies the form of disclaimer to be used under these circumstances. Opinion No. 15 of the Ethics Division has been rescinded. The new standards include the following considerations: The disclaimer should not state the reason for lack of independence nor imply that an examination was performed. It should take precedence over any other form of disclaimer, including cases where the scope of examination has been limited. The notation "unaudited - see accompanying disclaimer of opinion" should appear on each page of the financial statements.

COMMITTEE COMMENTS ON FEDERAL HOME LOAN BANK BOARD REGULATIONS

The Institute's committee on savings and loan accounting and auditing has made the following comments on the Dec. 22, 1969 regulations issued by the FHLBB relating to "liquidity" and "accounting for gains and losses with respect to transactions in securities."

Basically, the new liquidity regulation requires that insured associations maintain investments in "liquid assets" (as defined) equal to an amount not less than 5 1/2% of "net withdrawable accounts" (as defined). Assets defined in the regulation as liquid assets include "obligations of the United States." In calculating the 5 1/2% investment in liquid assets subsequent to Dec. 31, 1971, the regulation requires, "...except as the Board may otherwise direct in a specific case...," that associations maintain not less than 2% in "liquid assets" maturing in one year or less and restricts the inclusion of "liquid assets" maturing in more than seven years to no more than 1/2 of 1%.

In the absence of a directive issued by the FHLBB exempting an association from this determination of liquid assets, it is possible that an association may be forced to sell investments in obligations of the United States to meet future liquidity requirements. In such cases, failure to make adequate provision at Dec. 31, 1969 for anticipated future losses may require the independent auditor to qualify or disclaim an opinion.

The regulations provide for the use of the completed-transaction method for securities gains and losses as a general rule. However, it also permits an association to elect to defer and amortize, over a period of not more than 10 years, all gains and losses on securities transactions entered into for liquidity purposes during the period up to December 31, 1971, and related reinvestment transaction thereafter.

Such deferral and amortization of security gains and losses, in the committee's view, is not in accordance with generally accepted accounting principles. In reaching its conclusion, the committee considered the deferral and amortization method of accounting for gains and losses arising from security transactions which was approved for use by banks under certain specified conditions, but believes that such a method is not acceptable for use within the savings and loan industry. Conditions under which the use of the deferral and amortization method has been considered acceptable for banks, namely, tax motivated switches into similar investment grade, fixed-income investments, are not present in the savings and loan industry under present federal tax law. Where an association has adopted the deferral and amortization of method and where its effect on financial condition or results of operations is material, the independent auditor should issue a qualified or adverse opinion.