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Volume 29 | Issue 1 Article 3

12-1966

Everybody Talks About It

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Not the weather, in this instance, but the need for improved financial reporting. This was emphasized by both outgoing President Thomas D. Flynn and incoming President Robert M. Trueblood at the 78th annual meeting of the American Institute of Certified Public Accountants in Dallas, September 19-22, 1965.[1] The same theme was stressed in the papers presented at the Hayden, Stone and Company, Inc., Fourth Annual Accounting Forum, New York University Graduate School, on November 18, 1965.[2] In 1965, delegates from fifteen Asian-Pacific countries meeting at New Delhi, India, at the Fourth Asian-Pacific Accounting Conference discussed "the need for developing international terminology and uniform accounting practices."[3]

Everybody talks about the need for improved financial reporting, but is anybody doing anything about it?

A prominent member of the accounting profession stated that "a great many people are giving a lot of attention these days to improvements in corporate financial reporting in a number of directions."[4] Evidence of this can be found throughout the accounting literature, but it is proposed herein that the primary direction of this attention should be in the development of a precise terminology, the lack of which was an important weakness in the development of accounting principles during the 1930's and 1940's.[5] At that time "there was a tendency (which unfortunately has persisted) for each writer or group to use terms as he saw fit; sometimes the usage was explained, and sometimes it was taken for granted that it would be understood."[6] In the matter of terminology, "accountants have been extremely careless . . . and the situation has degenerated to such a state that it is doubtful whether accountants really understand each other. The formulation of a set of precise terms is prerequisite to development in any field of endeavor."[7]

A president of the American Institute of Certified Public Accountants said "that many of the tasks facing the profession come down to a matter of communication."[8] This was evident in some of the criticism directed against Accounting Research Study No. 3.[9] Several of the proposed principles "which have been manifested in financial statements for years and presumably, therefore, are generally accepted"[10] had been identified as "radical departures" from practice.

Throughout the accounting literature, examples can be found wherein accounting principles are equated with accounting procedures. But "principles" and "procedures" are not synonyms. This confusion is at the core of the many animated controversies generated since the implementation of the AICPA's new research program in 1959. A current article points out that:

> One of the more serious omissions of all statements on accounting principles is adequate preliminary discussion of the manner in which "principles" is to be interpreted. There is a tendency to suppose that we can get along quite well without exercises in definition. In no other field having any pretension to rigor of thought or development is this presumption entertained.[11]

It is sometimes pointed out that in the area of auditing this confusion does not exist, or has not existed. There is a statement of generally accepted auditing standards, and there are Statements on Auditing Procedures and Case Studies in Auditing Procedures on particular matters. A very important distinction has been made between auditing standards (which do not change) and auditing procedures (which must adapt to the environment).

This distinction was carefully guarded until 1963 when the Committee on Auditing Procedure of the AICPA issued Statements on Auditing Procedure No. 33, entitled *Auditing Standards and Procedures.* Now this dis-

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[1] "News Report," The Journal of Accountancy, Volume 120, November 1965, p. 12.

[2] "Statements in Quotes," The Journal of Accountancy, Volume 121, February 1966, pp. 47-55.

[3] "News Report," The Journal of Accountancy, Volume 121, March 1966, p. 18.

[4] Herman W. Bevis, "Earnings per Share and the Need for Full Disclosure," The Journal of Accountancy, Volume 121, February 1966, p. 52.

[5] Reed K. Storey, *The Search for Accounting Principles,* The American Institute of Certified Public Accountants, Inc., 1964, p. 61.

[6] *Ibid.*, p. 21.

[7] *Ibid.*, p. 62.

[8] Robert M. Trueblood, "A Forward-Looking Forum," The CPA, Volume 45, December 1965, p. 2.

[9] Robert T. Sprouse and Maurice Moonitz, *A Tentative Set of Broad Accounting Principles for Business Enterprises* (New York: AICPA, 1962).

[10] Robert T. Sprouse, "The 'Radically Different' Principles of Accounting Research Study No. 3," The Journal of Accountancy, Volume 117, May 1964, p. 64.

[11] R. J. Chambers, "A Matter of Principle," The Accounting Review, Volume XLI, July 1966, p. 447.

tinction has become blurred and we are venturing out on troubled waters if we do not heed a former chairman of the Institute's auditing procedure committee. He said:

> It is highly important to the profession and to the public that the aberrations in the distinctions between generally accepted auditing standards and auditing procedures be corrected as soon as possible. I believe it was a mistake to merge generally accepted auditing standards in a codification of the committee's Statements on Auditing Procedure. If such a merger was to be made, considerably greater care should have been taken to preserve the distinctions than is evident in the present structure of SAP No. 33.[12]

In an attempt to promote uniformity in the usage of accounting terms, the 1952-1953 Committee on Terminology of the AICPA stated that "events have forced accountants to give more careful consideration to the use of words, as the responsibilities that may flow from careless or inaccurate usage have become more serious and manifest."[13] The Committee made specific recommendations as to word usage and in AICPA's yearly publication of *Accounting Trends and Techniques*, reporting practices of 600 corporations are compared to the Accounting Terminology Bulletins.

Rugged individualism and ingrained habits notwithstanding, some of the recommendations have influenced reporting practices. The troublesome word "reserve" is used less frequently to describe uncollectible accounts, giving way to "allowance" in the majority of the reports analyzed.[14] In the area of Property, Plant and Equipment, the term "reserve" is being used infrequently; "accumulated depreciation" is the preferred terminology.[15] As a "liability reserve," the term was used by only 6% of the companies included in the survey in connection with an Income Tax Liability; over 75% of the companies indicated a preference for the terms "estimated" or "accrued."[16]

Another troublesome word, "surplus," was considered by the Committee on Terminology. "In 1949, this committee secured the approval of the committee on accounting procedure for its recommendation that the use of the term "surplus" in balance-sheet presentations be discontinued."[17] As a result, a survey of the reporting practices of 600 corporations revealed that 54% of the companies had replaced the term "surplus" with more descriptive terminology.[18]

At this point, however, some inconsistencies appear. Section 4 of *Accounting Trends and Techniques* is entitled "Retained Earnings and Capital Surplus" but contains the following paragraph:

> The term *capital surplus* is used in this section to classify all surplus accounts exclusive of retained earnings. Although the committee on terminology of the American Institute of Certified Public Accountants has recommended a general discontinuance of the use of the term *surplus* in corporate accounting and this objective has been approved by the committee on accounting procedure, the term *capital surplus* is used here as a technical term to indicate the nature of the accounts discussed.[19]

In the advertisement[20] prepared for the promotion of *Accounting Trends and Techniques*, "capital surplus" is distinctly listed. The implication seems to be that there is no objection to the term "surplus" in describing a section of the balance sheet. In this way, and because *Accounting Trends and Techniques* is used as a reference source by many accountants, the use of the term "surplus" is being perpetuated; the arguments against its use as part of Stockholders' Equity are being nullified.

In *Professional Accounting in 25 Countries* published by the AICPA in 1964, there are many references to "surplus" in the chapter describing accounting in the United States of America. In the Illustrative Balance Sheet, Exhibit 1(a), under the heading "Capital," the term "surplus" appears with "Earned Surplus" as a sub-heading. Exhibit 1(b) is entitled "Illustrative Statement of Income and Earned Surplus of a United States Company." Presumably, these model statements will be of interest to both national and international accountants. Have not the efforts of the Committee on Terminology been negated with this example?

In defining accounting, the Committee on Terminology stated that it was the

> . . . art of recording, classifying, and

[12] Paul Grady, "The Independent Auditing and Reporting Function of the CPA," The Journal of Accountancy, Volume 120, November 1965, p. 66.

[13] Committee on Terminology, "Accounting Terminology Bulletins, Number 1, Review and Resume," p. 7, *Accounting Research and Terminology Bulletins, Final Edition, 1961,* New York, AICPA.

[14] Staff of the AICPA, *Accounting Trends and Techniques—1964 Eighteenth Edition,* AICPA, 1964, pp. 36-37.

[15] *Ibid.,* pp. 60-61.

[16] *Ibid.,* pp. 85-86.

[17] Committee on Terminology, *op. cit.,* p. 15.

[18] Staff of the AICPA, *op. cit.,* pp. 10-11.

[19] *Ibid.,* p. 211.

[20] The Journal of Accountancy, Volume 120, November 1965, p. 90.

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Financial Statements for the Transnational Enterprise

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to the price of gold, it would have additional stability. Thirdly, an imaginary unit may be used by all transnational enterprises regardless of the location of their operations and shareholders, and would therefore contribute to the comparability of their respective financial statements.

Adjusting for Price Level Changes

The accounting profession in the United States has been concerned about inflation for a long time. Various studies have been made on accounting for price-level changes but have brought about no changes in accounting principles in the United States.

Accountants abroad have been much more progressive, perhaps mainly because the faster rate of inflation in their countries forced them to adjust accounting concepts. In most instances, accountants of other countries expressed historical costs at the new values of their respective currencies. The Dutch went one step beyond this and are using replacement costs in revaluing assets.

As far as finding a basis for a valuation of the assets and liabilities of transnational enterprises is concerned, neither unadjusted historical cost nor replacement value seems suitable. Domestic financial statements based on historical cost reflect a mixture of currency units of different value, and such a mixture does not normally result in meaningful figures. The use of unadjusted historical cost in reports of the transnational enterprise is even more unrealistic because a great many currencies may be involved, some of which have experienced drastic changes in value. The replacement value method, while it seems to work very well in The Netherlands, has not found acceptance anywhere else.

One method that satisfies the need for an adjustment of the accounts to changes in the purchasing power of money and yet does not stray too far from accounting conventions is the valuation of assets and liabilities based on historical cost adjusted for price-level changes. This method has the advantage of majority approval since it is now in use in most countries. Should Accounting Research Study No. 6 be approved by the Accounting Principles Board, United States accountants should have no objections to employing historical cost adjusted for price-level changes in the reports of international enterprises.

The procedure of adjusting for price-level changes is conservative in that it does not abandon cost concepts. It is progressive because it does recognize that currencies expended in different years carry different values and it adjusts them accordingly.

Exchange Rates

After the accounts have been adjusted for changes in the purchasing power of money (needless to say, this would not normally be done in the books of account but only for the purpose of preparing financial statements), it must be determined which exchange rate should be used in order to translate the respective currencies into that fictional unit which is to serve as the common monetary unit in the report of the transnational enterprise. Since all accounts before translation have already been expressed in money of uniform value, the exchange rate no longer has the function of converting monetary units of differing value of one currency into monetary units of uniform value of another currency. Consequently, the selection of the proper exchange rate no longer poses a difficult problem. All items in the financial statements may be translated at the current rate.

The translation of currencies often results in gains or losses, the disposition of which poses additional problems. A discussion of alternative treatment of these translation gains and losses is beyond the scope of this article.

Conclusions

The method of preparing financial statements for the transnational enterprise which has been outlined is fairly simple and straightforward. Such statements satisfy the need for consistency and comparability. They are based on the cost principle which is in effect in a majority of countries. They are relatively free from distortions.

While the underlying accounting records would be kept in accordance with local law and custom in order to comply with the various government regulations in effect, the financial statements would be designed to afford the stockholders of the transnational enterprise a better understanding of the condition and results of operations of the corporation in which they have invested their funds.

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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.[21]

[21] Committee on Terminology, *op. cit.*, p. 9.

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EDITOR'S PAGE

All of the feature articles in this issue are concerned with financial reporting, an area of much controversy and criticism and of much study and research. It comes up for frequent consideration because it is so important not only to our profession but also to all the individuals and groups in the business world, in the financial community, in government and in the general public who read and interpret financial reports. We hope that the articles presented will bring you some of the current ideas and thinking and stimulate your interest in this vital matter.

AUTHORS IN THIS ISSUE

One of the technical sessions at the 1966 AWSCPA-ASWA joint annual meeting in Boston consisted of four plenary sessions at which trends of special interest to the accountant were discussed. The first article in this issue, "Trends of Special Interest to the Accountant in Financial Reports," is the manuscript of a talk given at one of the sessions. The author, Katherine M. West, CPA, is assistant professor in The City University of New York (Brooklyn College) and engages in her own public accounting practice. Miss West received her A.B. (cum laude) degree from Hunter College and her M.S. degree from Columbia University. She is a member of both AWSCPA and ASWA and of numerous other professional accounting organizations. She is a past president of the New York Chapter of ASWA.

"Financial Statements for Transnational Enterprises" deals with perplexing problems in international accounting, an area of accounting which is becoming increasingly important. The author, Anita I. Tyra, CPA, teaches accounting at the Bellevue Community College in Bellevue, Washington. Mrs. Tyra is a member of AWSCPA and the Seattle Chapter of ASWA. She holds an M.A. degree in Business Administration from the University of Washington.

The article entitled "Everybody Talks About It" was written in response to the editor's invitation to the members of AWSCPA and ASWA to submit articles for publication. The author, Wilhelmina H. Zukowska, CPA, has written that she feels quite strongly about the problem of terminology and had been trying for some time to find time to put her thoughts down on paper. Miss Zukowska is an assistant professor of accounting at The University of Miami at Coral Gables, Florida. She is a member of AWSCPA and has submitted an application for membership in the Miami Chapter of ASWA. She is also a member of several other professional accounting organizations.

EDITORIAL BOARD CHANGES

Recognition of retiring editorial board members and introduction of new members will appear in the February 1967 issue.

CHANGE OF ADDRESS

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The image arises that accounting is . . . recording, classifying, and summarizing—with interpreting (a most significant part of the definition) appearing as an afterthought. The image is not what many think it should be. Often in the accounting literature, accounting has been defined as the measurement and communication of financial and other economic data. In the American Accounting Association's 1966 *Statement of Basic Accounting Theory*, accounting is defined "as the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information."

It is questioned whether the time is not ripe for a serious reexamination of all Accounting Terminology Bulletins. In the meantime, some effort should be made toward achieving a cohesive relationship between the Bulletins and all publications of the American Institute of Certified Public Accountants, including advertisements. The image of the profession which we are projecting to the public is being muddied by our definition of accounting and the inconsistent use of suggested terminology.