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THEORY AND PRACTICE

Current Studies and Concepts

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ORGANIZATION OF THE FINANCIAL ACCOUNTING STANDARDS BOARD

In the July 1972 issue this column carried a review of the *Study on Establishment of Accounting Principles* which set forth the details of the proposed replacement of the Accounting Principles Board of the American Institute of Certified Public Accountants (AICPA) by a group completely separated from all other professional bodies. This group is to be known as the Financial Accounting Standards Board. A report on the progress made toward the establishment of the Board was made at the Annual Meeting of the AICPA this past October. A summary of that report follows.

The organization of the Financial Accounting Standards Board (FASB) is proceeding along the lines proposed by the original study group. Since the study group's recommendations were reviewed in the July column, they will not be repeated at this time. The trustees of the Financial Accounting Foundation were appointed this summer and have since then been working to accomplish the two major duties assigned to them: the appointment of the members of the FASB and the funding of its operations. The Trustees appointed five committees from among its members to work in the following areas:

1. Fund raising
2. Headquarters site selection
3. Selection of FASB members
4. Personnel policies
5. Rules of procedure

Committee Activities

The Fund Raising Committee has estimated that an annual budget of about three and one-half million dollars will be required. The consensus of the committee members is that two million of this amount should come from the accounting profession, one million from industry, and one-half million from the academic and financial community. The Committee expects to secure exemption from taxation under Section 501(c)(3) of the Internal Revenue Code.

The Headquarters Site Committee has determined the criteria for selection of a permanent site for the Foundation and for the FASB. Among the major items given consideration were:

- a. ability to recruit top-quality people
- b. accessibility to stock exchanges
- c. accessibility to the Securities and Exchange Commission
- d. accessibility to financial libraries
- e. availability of adequate space
- f. ability to give a "good image" to others.

Since the AICPA's Annual Meeting in October it has been announced that Greenwich, Connecticut, was selected as the headquarters site.

The Committee appointed for the selection of FASB members first attempted to set up requirements for selection to the Board and the procedures to be used in selecting its members. Subsequently letters seeking candidates were sent to persons well versed in the problems of financial reporting. Consideration was given to working conditions, salaries, fringe benefits, etc. It is the Committee's goal to complete the selection process by the end of 1972. Late in October the Foundation announced the appointment of Marshall S. Armstrong, a former president of the AICPA, as chairman of the FASB.

The Committee on Personnel Policies considered, among other things, such knotty problems as what personal investments could properly be held by members of the FASB. Although the term of office for Board members would be only five years (with a possible second term of an additional five years) the Committee determined that the Board members should have no financial interests in their former businesses or companies and no assurance that they could return to their former employers when their term of office had ended. These decisions were made in the hope that members of the Board can be completely removed from any pressures which might interfere with their objective considerations of matters before the Board.

The Rules of Procedure Committee was

charged with devising rules under which the FASB will operate. Much of the Committee's time was taken up with consideration of such items as the manner in which proposed opinions of the Board are to be exposed, the ways in which public hearings are to be held, the extent to which research should precede exposure drafts, etc. The Committee hopes to secure the reaction of all segments of the public before the Board issues each pronouncement.

From this brief summary of the activities of the Trustees since their appointment it can be seen that much effort has been expended in the effort to have the new FASB in existence and ready to assume its duties by the early part of 1973.

Objectives of Financial Statements

The American Institute of Certified Public Accountants (AICPA) appointed a committee headed by a former president, Robert Trueblood, to study and report on the objectives of financial statements. This committee has been working for more than a year. During that time it completed over fifty meetings with financial statement users, held public hearings, and examined over one hundred technical papers. Following that it started sorting out and discussing the major issues involved.

The committee has been careful to distinguish "objectives" from "principles." Some persons in the profession have felt that there should be only a single objective—to help investors make rational decisions on the basis of the most informative financial information available to them. Others have expressed quite different thoughts. The committee recognizes that the predictive purposes of financial statements are very important; it therefore is aware of the need for statements giving projections.

Tentative conclusions have been reached that (1) it must be made clear that financial reports by themselves cannot reach conclusions, (2) "scorekeeping" must be preserved, and (3) financial pronouncements must be useful to the average practitioner—not contribute some ivory-tower report which will only occasionally be removed from the shelf.

The foregoing are some of the thoughts expressed by the Chairman, Mr. Trueblood, at the annual meeting of the AICPA in Denver. While the committee was not yet ready to make a formal report, it was hopeful that some kind of report could be made to Council of the In-

stitute at its regular meeting in the Spring. Whether this report was expected to be preliminary in nature or a final report was not indicated.

The importance of the matters being considered by the committee on Objectives of Financial Statements can hardly be overstated. The close relationship between the objectives and the principles which are to be developed to attain them make it of vital concern to all practicing accountants to keep in close touch with the progress and reports of both the Trustees of the Financial Accounting Foundation and the Trueblood committee's study of the Objectives of Financial Statements.

The Auditor's Study and Evaluation of Internal Control

An exposure draft, dated August 10, 1972, was issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants dealing with the auditor's study and evaluation of internal control. Accountants in industry as well as those in public practice will be interested in reviewing the conclusions set forth in this proposed pronouncement.

The draft sets forth the purpose of the auditor's study and evaluation. This is followed by previous definitions and an expression of the need for clarification because of possible differences in interpretation of two of the key elements of internal control: the safeguarding of assets and the reliability of financial records. Based on a consideration of these two key elements, the committee proposes a revised definition of administrative control and accounting control.

Following these revised definitions a lengthy discussion on basic concepts is set forth. Then the draft considers the study of the system of internal control, the evaluation of that system, and the correlation of that evaluation with other auditing procedures.

Since the study and evaluation of internal control constitute the basis for the auditor's decisions on the extent of testing required in order to form an opinion, this editor would urge that readers give their attention to this pronouncement of the Committee on Auditing Procedures. The draft includes, for the first time, two appendices relating to statistical sampling and gives some specifics as to appropriate precision and reliability levels, which should be of considerable assistance to auditors.