Woman C.P.A.

Volume 36 | Issue 4 Article 3

10-1974

# Theory & Practice: The AICPA's AccSEC and AudSEC and the FASB

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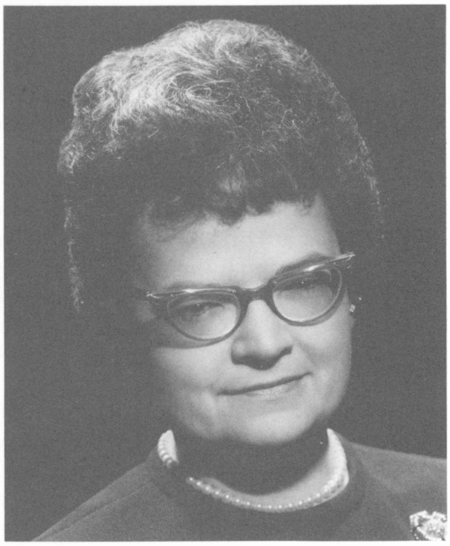

# Theory & Practice

## THE AICPA's AccSEC and AudSEC and the FASB

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**AICPA - Accounting Standards Division Executive Committee**

Since the AICPA relinquished its authority to issue authoritative, enforceable pronouncements on accounting principles to the FASB, the role of this Committee (AccSEC) in issuing pronouncements has been somewhat unclear. The FASB expressed its concern that the position papers which AccSEC was issuing would create "de facto" accounting standards. To resolve the problem, the Accounting Standards Division published its responsibilities and pronouncement policies in the July 1974 issue of *The CPA Letter:*

- The Accounting Standards Division has responsibility for maintaining liaison, on behalf of the AICPA, with the FASB, SEC, CASB (Cost Accounting Standards Board), stock exchanges and other bodies having authority over financial accounting and reporting standards.
- Responsibilities of AccSEC include:
  - Commenting on accounting and reporting standards and interpretations proposed by the FASB and other regulatory bodies.
  - Initiating accounting and reporting proposals.
  - Clearing references to accounting and reporting positions included in statements issued by any AICPA committee.
- Procedures of AccSEC with respect to pronouncement policies:
  - Written communications will be in two forms — Statements of Position, which will include a caveat that they do not establish enforceable standards, and less formal position letters.
  - Statements of Position will be prepared on each FASB discussion memorandum. Letters will be sent to the FASB commenting on its exposure drafts of standards and of interpretations.
  - Problems identified as requiring interpretation or a new standard will be described in letters to the FASB with suggested solutions when feasible.
  - Request for comments by government agencies and other regulatory bodies will be handled by letter and if an accounting principle or its interpretation is involved, a recommendation will be made that the matter be dealt with by the FASB.
  - AccSEC chairman will clear letters prepared by the AICPA's separate CASB committee commenting on proposals of the Cost Accounting Standards Board.
  - AccSEC chairman will approve Statements of Position prepared by AICPA task forces and addressed to the FASB proposing amendments to existing AICPA Accounting and Audit Guides.
  - AccSEC chairman will clear descriptions of current financial accounting and reporting practices (new practices may not be recommended) included in any new AICPA Audit Guide.

AccSEC has submitted comments on each FASB discussion memorandum and on various SEC proposals to amend its rules relating to financial statements and disclosures or affecting the work of the auditor. Several letters have been sent to the FASB requesting interpretation of specific paragraphs of prior opinions of the Accounting Principles Board, and bulletins of the Committee on Accounting Procedure and other letters are in various stages of preparation.

A Statement of Position on Recognition of Profit on Sales of Receivables With Recourse was published on June 14, 1974 as a recommendation to the FASB for development of an accounting standard. The statement takes the position that a uniform accounting approach is desirable for the recognition of profit or loss on sales of receivables with recourse and that the "delayed recognition" method rather than the "immediate recognition" method is preferable. An example of the type of transaction considered is the endorsement fee charged by Mobile Home Retailers when the customer finances the purchase price with the retailer.

The committee's agenda covers many current accounting problems, but only a few will be mentioned now. The first draft of a Statement of Position on Presentation and Disclosure Standards for Financial Forecasts has been completed. When this document is finalized, it will be submitted to the FASB and will be available to members of the AICPA. A recommendation to the FASB for development of an accounting standard on revenue recognition when a right of return exists is in process. Another project for ultimate referral to the FASB is an analysis (without conclusions) of the major issues regarding real estate investment trusts.

AICPA — Auditing Standards Division Executive Committee

This Committee (AudSEC) issues pronouncements on auditing standards and procedures. These procedures are enforceable under the AICPA Code of Professional Ethics.

You will recall that Statements on Auditing Procedure Nos. 33 through 54 were codified in Statement on Auditing Standards No. 1 published in 1973. Since then exposure drafts of two proposed Statements on Auditing Standards have been issued for comment from interested persons.

An exposure draft entitled "Reports on Audited Financial Statements" distributed in May 1974 represented a substantial revision of an earlier draft issued in August 1973. If adopted in its present form:

- A "subject to" opinion will be the accepted means of expressing an auditor's reservations arising from the outcome of uncertainties; however, an auditor will not be precluded from disclaiming an opinion.
- A separate explanatory paragraph will be required if the auditor's opinion is qualified or adverse, or if an opinion is disclaimed.
- Piecemeal opinions will no longer be appropriate for use.
- When financial statements for the current year are accompanied by those for the prior year, the auditor will be expected to report on both years if both have been examined.

These proposals, if adopted, would be effective for reports on financial statements for periods ending on or after December 31, 1974, except the prohibition of piecemeal opinions would be effective for reports on financial statements for periods ending on or after January 31, 1975.

The initial exposure draft on the second proposed standard entitled "The Effects of Electronic Data Processing on the Auditor's Study and Evaluation of Internal Control" was mailed at the end of July 1974. The need for an auditor to understand an entire computer system sufficiently to evaluate its essential accounting control features is emphasized. The use of computers in recording data influences the manner in which an auditor reviews and evaluates the internal controls over the process. The auditor's choices regarding reliance on various controls within an EDP system are outlined and alternative actions including non-computer controls when a system is inadequate are suggested. While recognizing the EDP systems can be changed without visible evidence, permitting the recording of spurious records and unauthorized transactions, the exposure draft also acknowledges that the use of a computer system often provides an opportunity to improve accounting control of recorded transactions since it is not subject to errors caused by fatigue or carelessness, and it processes like transactions in a like manner.

Some of the other subjects on the committee's agenda include:

- Reporting on forecasts.
- Recommended procedures regarding use of financial statement data outside of the financial statements and related notes in documents such as annual reports.
- Development of procedures to determine the existence of transactions with related parties.
- Reporting on and association with interim financial statements.
- Audit supervision
  - Considerations of a CPA firm in maintaining the quality of its auditing practice.
  - Guidance to the supervisory members of an audit team in the field in applying the first generally accepted auditing standard of field work.
- Use of the work of a person skilled in a discipline other than accounting by an auditor in forming an opinion on financial statements.
- Using the work of internal auditors.
- Reporting on price-level financial information.
- Reporting on common trust funds.
- Determination of reporting requirements which should be followed between the points in time when the FASB pronouncements identify a standard and its effective date.

**FASB — An Update**

The FASB is diligently pursuing its announced agenda and flooding the mails with its discussion memoranda and exposure drafts. Before considering the contents of these memoranda and drafts, a brief review of the procedures usually preceding issuance of a Statement of Financial Accounting Standards might be in order. A task force is chosen which defines the problem, determines the nature and extent of research to be done, and prepares a discussion memorandum outlining alternative solutions without stating any conclusion. A public hearing takes place 60 days after distribution of the discussion memorandum. Next, an exposure draft based on the papers submitted and testimony at the public hearing is prepared and distributed for comments from interested parties. Then following evaluation of the comments received on the exposure draft, a Statement of Financial Accounting Standards is prepared and, if voted upon affirmatively by five of the seven FASB members, it is issued.

After distribution of a discussion memorandum covering research and development and similar costs as related to both operating companies and companies in the development stage in December 1973 and a public hearing in March 1974, two exposure drafts were issued.

The first draft was a proposed statement relating only to research and development costs of operating companies. It was distributed on June 5, 1974 and comments were requested by August 5, 1974. The research and development costs included under this proposed standard would consist of:

a. materials, equipment and facilities,
b. personnel,
c. intangibles purchased from others,
d. contract services and
e. indirect costs, but not general and administrative costs which are not directly related to the research and development activities.

Only costs related to research activities aimed at discovery of new knowledge which it is hoped would be commercially useful and the translation of such research findings into new or improved products, processes or services capable of commercialization, including prototype and pilot operations, would be considered research and development costs. All research and development costs not directly reimburseable by outside parties would be charged to operations when incurred and the amount included in expense during the period would be disclosed in the financial statements. If adopted, the provisions of this Statement would be effective for all research and development costs incurred during fiscal years beginning on or after January 1, 1975. Any deferred research and development costs incurred prior to that date would be written off as a prior period adjustment.

A second exposure draft entitled "Accounting and Reporting by Development Stage Companies, Subsidiaries, Divisions and Other Components" was issued July 19, 1974 and comments were requested by September 30, 1974. The FASB has concluded that companies in the development stage require no special accounting standards. The Statement, if adopted, would require entities in the development stage to

a. charge to expense as incurred during the development stage those costs which would be charged to expense as incurred when the entity is no longer in the development stage,
b. capitalize or defer only those types of costs which may be capitalized or defer-

red subsequent to the development stage,

c. report sales of goods or services, interest or other income as revenue in the income statement,

d. assign dollar amounts to shares issued for non-cash consideration, and to the consideration (asset or service) received, at the time of issuance of the shares, and

e. report cumulative net losses as "accumulated deficit" in the stockholders' equity section of the balance sheet. The primary financial statements would be

1. a balance sheet,

2. an income statement showing cumulative amounts from inception as well as amounts for the period,

3. a statement of changes in financial position showing cumulative and period amounts, and

4. a statement of owners' investment showing each issuance since inception.

Presently development stage companies usually present statements of assets and unrecovered development costs, liabilities, capital shares, and receipts and disbursements. The Statement, of course, does not consider the auditors' problems in reporting upon the statements proposed. Guidelines for identifying an entity in the development stage are included in the statement. The effective date and provision for prior-period write-off are the same as in the statement on research and development costs. An additional exposure draft on "similar costs" such as market research, promotion, training and relocation and rearrangement is currently being considered by the FASB.

Other projects on the agenda for which discussion memoranda have been distributed and public hearings have either taken place or have been scheduled are:

- *Reporting the effects of general price-level changes in financial statements:*

  The basic question is "should reporting of the effects of general price-level changes be required as supplemental information to the conventional historical-dollar financial statements?" It was pointed out that restatements of accounting information for changes in the general level of prices does not measure the "current value" of a company's assets and liabilities. Price-level restatement is based on historical costs adjusted by use of an index of the general purchasing power of the dollar.

- *Accounting for foreign currency translation.*

  The three basic questions involved here are
  a. determination of the objective of translation — whether the objective is still expression of foreign currency amounts in terms of U.S. dollars as if the foreign currency transactions had been executed in dollars,
  b. determination of which of the assets and liabilities of foreign entities should be adjusted for changes in exchange rates, and
  c. determination of the nature of an exchange adjustment — a gain or loss or an adjustment of other accounts.

- *Accounting for future losses.*

  Four possible criteria for accrual of future losses, such as self-insured losses and losses from expropriations by foreign governments, are listed in the discussion memorandum. These are
  a. there is an existing condition or set of circumstances that may result in a loss,
  b. the occurrence of the loss is sufficiently predictable,
  c. the loss is properly chargeable to current revenues or is reasonably related to the operations of the current period or a prior period, and
  d. the loss can be measured with reasonable approximation.

- *Financial reporting for segments of a business enterprise.*

  The major question here is whether information about segments of a business enterprise should be included in financial statements and, if it should, what information should be included and how it should be presented. Also discussed in the memorandum are the approach to be taken in specifying the segments (organizational, such as divisions, branches or subsidiaries; or economic activity, such as industries, product lines, markets or geographical areas), whether common costs which are not traceable to individual segments should be allocated and, if so, on what basis, and whether intersegment transfers should be included in segment sales and, if so, how they should be priced.

- *Conceptual framework for accounting and reporting.*

  The discussion memorandum is based almost exclusively upon the report of the Study Group on the Objectives of Financial Statements, commonly known as the Trueblood Report. Consideration of the 12 proposed objectives of the Trueblood Report are the initial step in the FASB's ongoing project on the entire conceptual framework of accounting and reporting, including objectives, qualitative characteristics and the need of users of accounting information.

- *Accounting for leases.*

  The principal aspects of accounting and reporting for leases by lessees and lessors, including "leveraged leases", are discussed in the memorandum. It also compares and analyzes the arguments for and against capitalizing various types of leases by lessees and discusses different viewpoints as to what information should be included in notes to the financial statements.

Task forces have been appointed for the last two items on the agenda which are Criteria for Determining Materiality and Business Combinations and Related Intangibles. Materiality seems always to be an illusive concept; however, the stated aim of this project is a definition of the standard of materiality and criteria for its application. Even determination of the method of attacking the project on business combinations apparently presented a problem to the FASB. In April 1974 it was announced that there was great need for immediate action on the existing criteria for pooling of interests accounting and that that subject would be considered first. Then in June 1974 the FASB announced that it had decided to drop consideration of the criteria and concentrate on a total reconsideration of *Accounting Principles Board Opinions No. 16* and *17*. Basic questions will be whether the pooling of interests method is appropriate under any circumstances and the treatment of "goodwill". Considering the many years of controversy over business combinations before the APB issued its opinions and the fact that the AICPA has issued 39 interpretations of *APB No. 16*, most of which related to application of the criteria, and that the Securities and Exchange Commission has issued three Accounting Series Releases relating to the criteria, watching the steps in the development of an accounting standard by the FASB on this subject should be fascinating.